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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

**[TD 9946]**

**RIN 1545-BO67**

**Denial of Deduction for Certain Fines, Penalties, and Other Amounts; Related Information Reporting Requirements**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations providing guidance on section 162(f) of the Internal Revenue Code (Code), as amended in 2017, concerning the deduction of certain fines, penalties, and other amounts. This document also contains final regulations providing guidance relating to the information reporting requirements under new section 6050X of the Code with respect to those fines, penalties, and other amounts. The final regulations affect taxpayers that pay or incur amounts to, or at the direction of, governments, governmental entities or certain nongovernmental entities treated as governmental entities relating to the violation of any law or investigations or inquiries by such governments, governmental entities, or nongovernmental entities into the potential violation of any law. The final regulations also affect governments, governmental entities, and nongovernmental entities subject to the related reporting requirements.

DATES: Effective date: These regulations are effective on [INSERT DATE OF FILING FOR PUBLIC INSPECTION].

Applicability dates: For dates of applicability, see §§1.162-21(g) and 1.6050X-1(g).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations on amended section 162(f), Sharon Y. Horn (202) 317-4426; concerning the information reporting requirement, Nancy L. Rose (202) 317-5147. The phone numbers above may also be reached by individuals who are deaf or hard of hearing, or who have speech disabilities, through the Federal Relay Service toll-free at (800) 877-8339.

#### SUPPLEMENTARY INFORMATION:

##### **Background**

Prior to its amendment in 2017, section 162(f) disallowed an ordinary and necessary business expense deduction under section 162(a) for any fine or similar penalty paid to a government for the violation of any law. On February 20, 1975, the Treasury Department and the IRS issued final regulations under the prior version of section 162(f) (TD 7345, 40 FR 7437), which were amended on July 11, 1975 (T.D. 7366, 40 FR 29290) (together the 1975 regulations).

Section 162(f) was amended by section 13306(a) of Public Law No. 115-97, 131 Stat. 2054 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA).

Section 6050X was added to the Code by section 13306(b) of the TCJA.

As amended by the TCJA, the general rule of section 162(f)(1) provides that no deduction otherwise allowable under chapter 1 of the Code (chapter 1) 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 governmental entity into the potential violation of any law. Section 162(f)(5) describes certain self-regulating nongovernmental entities that are treated as governmental entities for purposes of section 162(f). As used in this preamble, the term “governmental entities” includes nongovernmental entities treated as governmental entities under section 162(f)(5).

Section 162(f)(2) provides an exception to the general disallowance rule in section 162(f)(1) for certain amounts paid or incurred for restitution, remediation, or to come into compliance with a law. Under section 162(f)(2)(A)(i) and (ii), section 162(f)(1) does not apply to amounts that (i) the taxpayer establishes were paid or incurred as restitution (including remediation of property) or to come into compliance with a law (establishment requirement), and (ii) are identified in a court order (order) or settlement agreement (agreement) as restitution, remediation, or amounts paid or incurred to come into compliance with a law (identification requirement). Section 162(f)(2)(B) provides that amounts paid for restitution, remediation, and to come into compliance with a law do not include any amount paid or incurred as reimbursement to a government or governmental entity for the costs of any investigation or litigation.

Section 162(f)(3) provides an exception to the general rule for amounts paid or incurred related to private party suits and section 162(f)(4) provides an exception for certain taxes due.

Section 6050X(a)(1) and 6050X(a)(2)(A) requires the appropriate official of any government or governmental entity involved in a suit or agreement described in section 6050X(a)(2)(A)(i) to file an information return if the aggregate amount involved in all orders or agreements with respect to the violation, investigation, or inquiry is \$600

or more. Section 6050X(a)(2)(B) authorizes the Secretary of the Treasury or his delegate (Secretary) to adjust the threshold amount for filing the information return as necessary to ensure the efficient administration of the internal revenue laws. Pursuant to section 6050X(a)(1), the information return must set forth (1) the amount required to be paid as a result of the order or agreement to which section 162(f)(1) applies; (2) any amount required to be paid as a result of the order or agreement that constitutes restitution or remediation of property; and (3) any amount required to be paid as a result of the order or agreement for the purpose of coming into compliance with a law that was violated or involved in the investigation or inquiry.

Section 6050X(a)(3) provides that the government or governmental entity shall file the information return at the time the agreement is entered into, as determined by the Secretary. Section 6050X(b) requires the government or governmental entity to furnish to each person who is a party to the suit or agreement a written statement, at the time the information return is filed with the IRS, that includes (1) the name of the government or entity and (2) the information submitted to the IRS.

Under section 13306(a)(2) and (b)(3) of the TCJA, the amendments to section 162(f) and new section 6050X apply to amounts paid or incurred on or after December 22, 2017, the date of enactment of the TCJA. However, they do not apply to amounts paid or incurred under any binding order issued or agreement entered into, before December 22, 2017, and, if such order or agreement requires court approval, the required approval is obtained before December 22, 2017.

On May 13, 2020, the Internal Revenue Service published a notice of proposed rulemaking (REG-104591-18) in the **Federal Register** (85 FR 28524) providing

guidance on the deduction disallowance rules in section 162(f) and the associated reporting requirements in section 6050X. No public hearing on the proposed regulations was requested and accordingly no public hearing was held.

The Treasury Department and the IRS received written comments in response to the proposed regulations. All comments were considered and are available at [www.regulations.gov](http://www.regulations.gov) or upon request. After full consideration of the comments received on the proposed regulations, this Treasury decision adopts the proposed regulations with modifications in response to such comments as described in the Summary of Comments and Explanation of Revisions.

### **Summary of Comments and Explanation of Revisions**

Most of the comments addressing the proposed regulations are summarized in this Summary of Comments and Explanation of Revisions. However, comments merely summarizing or interpreting the proposed regulations, recommending statutory revisions, or addressing issues that are outside the scope of the final regulations are not discussed.

Part I of this Summary of Comments and Explanation of Revisions addresses §1.162-21 and Part II addresses §1.6050X-1.

#### **I. Denial of Deduction for Certain Fines, Penalties, and Other Amounts**

##### **A. General rule**

The proposed regulations revise §1.162-21 and provide operational and definitional guidance concerning the application of section 162(f), as amended by the TCJA. The proposed regulations provide generally that a taxpayer may not take a deduction under any provision of chapter 1 for amounts (1) paid or incurred by suit,

agreement, or otherwise; (2) to, or at the direction of, a government or governmental entity; (3) in relation to the violation, or investigation or inquiry into the potential violation, of any civil or criminal law. The proposed regulations also describe an exception to the general rule, under section 162(f)(2), which allows a deduction for certain amounts identified in the order or agreement as restitution, remediation, or paid or incurred to come into compliance with a law and the taxpayer establishes that the amount was paid or incurred for the purpose identified.

The final regulations provide generally that a taxpayer may not take a deduction under any provision of chapter 1 for amounts (1) paid or incurred by suit, agreement, or otherwise; (2) to, or at the direction of, a government or governmental entity; (3) in relation to the violation, or investigation or inquiry by such government or governmental entity into the potential violation, of any civil or criminal law. This general rule applies whether or not the taxpayer admits guilt or liability or pays the amount imposed for any other reason, including to avoid the expense or uncertain outcome of an investigation or litigation. An admission of guilt or liability is not necessary because section 162(f)(1) contemplates a broader disallowance, as demonstrated by the disallowance of any amount paid or incurred, to, or at the direction of, a government or governmental entity in relation to the “investigation or inquiry” into the “potential violation of any law.”

#### 1. Suit, agreement, or otherwise

Under the proposed regulations, suit, agreement, or otherwise includes, but is not limited to, settlement agreements; non-prosecution agreements; deferred prosecution agreements; judicial proceedings; administrative adjudications; decisions issued by officials, committees, commissions, or boards of a government or

governmental entity; and any legal actions or hearings in which a liability for the taxpayer is determined or pursuant to which the taxpayer assumes liability.

Commenters asked that the final regulations exclude administrative and certain other categories of proceedings from the definition of suit, agreement, or otherwise. The final regulations do not adopt this recommendation because the statute's use of the phrase "suit, agreement, or otherwise" indicates that Congress intended for section 162(f)(1) to apply broadly to both formal legal proceedings as well as other less formal proceedings.

The preamble to the proposed regulations under section 6050X explains that an order or agreement is treated as binding under applicable law even if all appeals have not been exhausted with respect to the suit, agreement, or otherwise. A commenter recommended that the final regulations provide that the same meaning applies for the term "binding" order or agreement under section 162(f). The final regulations generally adopt this recommendation.

## 2. To, or at the direction of, a government or governmental entity

One commenter asked for clarification that, if a deduction is otherwise allowable under chapter 1, section 162(f)(1) does not disallow a deduction for amounts paid for the taxpayer's own legal fees and related expenses incurred in defending a prosecution or other action or proceeding, including an investigation or inquiry into a potential violation of any law. Legal fees and other expenses, such as stenographic and printing charges, paid or incurred in the defense of a prosecution or civil action arising from a violation of any law, or an investigation or inquiry into a potential violation of any law, are not amounts paid or incurred to, or at the direction of, a government or

governmental entity. Thus it is clear that section 162(f)(1) does not disallow a deduction for such amounts, and there is no need to clarify this rule in final regulations.

The proposed regulations provide a definition of “government or governmental entity.” The definition in the final regulations has been reorganized to provide a definition of a government in §1.162-21(e)(1) and to provide a definition of a “governmental entity” in §1.162-21(e)(2). The definitions are based on the definition in the proposed regulations but clarify that a political subdivision of a government includes a local government unit. No comments were received on the definition of “government or governmental entity” in the proposed regulations.

The proposed regulations define a nongovernmental entity treated as a governmental entity as an entity that exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange, as defined in section 1256(g)(7), or exercises self-regulatory powers, including adopting, administering, or enforcing laws and imposing sanctions, as part of performing an essential governmental function. The final regulations revise the definition to clarify that self-regulatory powers include enforcing rules, not laws. A commenter recommended that the definition of “essential governmental function” under section 115 should apply to section 162(f)(5). The final regulations do not adopt this recommendation because section 115 does not define the term “essential governmental function.” The final regulations clarify that a governmental entity includes a nongovernmental entity treated as a governmental entity.

### 3. Violation of any law

Commenters asked that the final regulations provide a definition of a “violation of any law.” The final regulations do not adopt this recommendation because they are intended to provide broad rules of general application based on the underlying principles of section 162(f) rather than narrow rules with limited application. The final regulations provide several examples to illustrate the application of section 162(f) to violations of any law.

Commenters also requested clarification that “technical violations” of any law, such as vendor overcharge errors remedied in the ordinary course of business, are not violations of any law. The commenters did not further define what constitutes a “technical violation.” Without a more comprehensive definition, the commenters’ requests may be inconsistent with the general rule in the final regulations. Therefore, the final regulations do not adopt this comment.

Commenters recommended that the final regulations clarify that the phrase “in relation to the violation of any law or the investigation or inquiry by such government or [governmental] entity into the potential violation of any law” do not apply to a government or governmental entity enforcing its legal rights, including defending against claims, as a private party. The Treasury Department and the IRS agree that, in general, unless a government contracting or similar statute provides otherwise, a government’s recovery of vendor overcharge errors are in the nature of private party recoveries and not payments made to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry in to the potential violation of any law. Similarly, as discussed with respect to private party suits in Part

I.B.6 of this Summary of Comments and Explanation of Revisions, a violation of any law does not include any order or agreement in a suit in which a government or governmental entity enforces rights as a private party.

Commenters asked the Treasury Department and the IRS how section 162(f) applies to amounts paid or incurred pursuant to certain statutes that contain provisions that may apply without any finding of a violation of law, such as the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA). CERCLA contains cleanup requirements and reimbursement provisions that generally apply even though there has been no violation of law. CERCLA also contains penalty provisions for specific violations of law. Although section 162(f) and the final regulations generally will not apply to CERCLA cleanup requirements and reimbursements required to be paid or incurred by provisions that apply without any violation of law, section 162(f) and the final regulations will apply to penalties required to be paid or incurred for violations of law, including penalties required to be paid or incurred by reason of a violation of specific CERCLA provisions.

#### 4. Investigation or inquiry into the potential violation of any law

The Treasury Department and the IRS received several requests for additional guidance concerning “the investigation or inquiry by [a] government or [governmental] entity into the potential violation of any law.” Commenters requested that the final regulations: (1) provide that an investigation or inquiry by such government into the potential violation of any law does not include a routine investigation, inquiry, audit, review, or inspection; (2) clarify when a routine investigation, inquiry, audit, review, or inspection ends and a non-routine investigation or inquiry begins; (3) clarify whether

payments related to an investigation or inquiry are deductible if the investigation or inquiry ends without a finding of a violation of any law; and (4) provide examples of routine investigations, inquiries, audits, reviews, or inspections that are not non-routine investigations or inquiries. In addition, some of the commenters requested guidance that is unique to an industry or a statute.

The Treasury Department and the IRS agree that, in general, section 162(f)(1) does not disallow a deduction for amounts paid or incurred in connection with investigations or inquiries of regulated businesses or industries conducted in the ordinary course of business if the payment is otherwise deductible as an ordinary and necessary business expense. Accordingly, the final regulations provide, in general, that amounts paid or incurred for routine investigations or inquiries, such as audits or inspections, required to ensure compliance with rules and regulations applicable to the business or industry, which are not related to any evidence of wrongdoing or suspected wrongdoing, are not amounts paid or incurred relating to the potential violation of any law. Therefore, section 162(f)(1) will not apply to disallow an otherwise deductible ordinary and necessary business expense for amounts paid or incurred for these routine investigations or inquiries. Examples to illustrate the application of this rule are provided in the final regulations.

In contrast, section 162(f)(1) explicitly disallows a deduction for amounts paid or incurred for an investigation or inquiry by the government or governmental entity relating to the potential violation of any law. Therefore, the final regulations do not adopt the commenters' recommendation that section 162(f)(1) does not apply to amounts paid or

incurred where, at the conclusion of the investigation or inquiry, there is no finding of wrongdoing, because the recommendation is inconsistent with section 162(f)(1).

The final regulations clarify that the investigation or inquiry must be one that is conducted by the government or governmental entity. Examples to illustrate the application of this rule are provided in the final regulations.

#### 5. Fine or penalty

The proposed regulations disallow a deduction for payments made, at the taxpayer's election, in lieu of a fine or penalty. No comments were received regarding this provision and it is retained in the final regulations. One commenter asked that the final regulations adopt a definition for "fine or penalty," and expressly state that both are not deductible. Although the final regulations do not provide a definition of "fine or penalty," they provide that an amount that is paid or incurred in relation to the violation of any civil or criminal law includes a fine or penalty.

#### B. Exception to general rule

Section 162(f)(2) provides an exception to the general disallowance rule for certain amounts identified in the order or agreement as, and established by the taxpayer to be, paid or incurred for restitution or remediation, or to come into compliance with a law. The final regulations provide definitions and other guidance on the operation of this exception.

##### 1. Restitution and remediation

###### a. General

The proposed regulations provide that an amount is paid or incurred for restitution or remediation 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 any law. Commenters requested clarification as to what comprises restitution or remediation and requested modifications to the proposed definitions. A commenter recommended that the final regulations distinguish between civil and criminal restitution and disallow the deduction for amounts paid as criminal restitution. The final regulations do not adopt this rule because section 162(f)(2) does not distinguish between civil and criminal restitution and applies to “restitution (including remediation of property) for damage or harm which was or may be caused by the violation of any law or the potential violation of any law.” Emphasis added. Nonetheless, it may be harder for a taxpayer to establish that an amount paid is restitution in the criminal context because of the punitive purpose underlying most criminal liability.

b. Restitution or remediation of the environment

One commenter asked whether the definition of “property” for which restitution or remediation may be provided includes the environment. Another commenter noted that restitution or remediation cannot redress irreparable harms to the environment or natural resources, such as, killing wildlife or destroying a species or an ecosystem caused by the violation of any law. The commenter recommended that the final regulations provide a special restitution and remediation rule to address amounts paid or incurred for irreparable harm to the environment, natural resources, or wildlife. The Treasury Department and the IRS agree, provided the identification and establishment requirements are met and the restitution or remediation has a strong nexus or connection to the harm to the environment, natural resources, or wildlife that the

taxpayer has caused or is alleged to have caused. The final regulations revise the definition of “restitution, remediation of property, and amounts paid to come into compliance with a law” to clarify that, if otherwise deductible under chapter 1, an amount is paid or incurred for restitution or remediation of the environment, wildlife, or natural resources if it is paid or incurred for the purpose of conserving soil, air, or water resources, protecting or restoring the environment or an ecosystem, improving forests, or providing a habitat for fish, wildlife, or plants, and has the requisite nexus with the harm that the taxpayer has caused or is alleged to have caused. Such amounts may include payments described in §1.162-21(e)(4)(A), to be used exclusively for the restitution or remediation of a harm to the environment, wildlife, or natural resources that the taxpayer has caused or is alleged to have caused or paid to a segregated fund or account established by, or at the direction of, the government or governmental entity for the restitution or remediation of harm to the environment, wildlife, or natural resources that the taxpayer has caused or is alleged to have caused, provided, pursuant to the order or agreement, the amounts are not disbursed to the general account of the government or governmental entity for general enforcement efforts or other discretionary purposes.

c. Disgorgement or forfeiture

Under the proposed regulations, the section 162(f)(2) exception to the general deduction disallowance rule does not apply to forfeiture or disgorgement. Therefore, the proposed regulations treat any amount paid or incurred as forfeiture or disgorgement as, per se, disallowed under section 162(f)(1). To support excluding disgorgement from the definition of restitution, remediation, or amounts paid to come

into compliance with a law, the preamble to the proposed regulations quote Kokesh v. Securities and Exchange Commission, 137 S. Ct. 1635, 1643 (2017) (“[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains”). In Kokesh, the Supreme Court determined that disgorgement, when imposed as a sanction for violating a Federal securities law, constitutes a penalty under the related five-year statute of limitations because disgorgement is imposed to deter violations of securities laws by depriving violators of their ill-gotten gains and because the funds are dispersed to the United States Treasury to redress a wrong to the public at large caused by the violation. Kokesh, 137 S. Ct. at 1642-44. However, in Kokesh, the Supreme Court recognized that disgorgement may serve a compensatory purpose as well (“wrong sought to be redressed is . . . a wrong to the individual;” “[s]ome disgorged funds are paid to victims”). Id.

To support excluding forfeiture from the definition of restitution, remediation, or amounts paid to come into compliance with a law, the preamble to the proposed regulations quotes Nacchio v. United States, 824 F.3d 1370, 1379 (Fed. Cir. 2016) (“[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.”) In Nacchio, the United States Court of Appeals for the Federal Circuit disallowed the taxpayer’s deduction for the amount of mandatory forfeiture pursuant to a criminal conviction for insider trading, even though the government, in its discretion, subsequently used the forfeited funds to compensate victims.

Several commenters asked the Treasury Department and the IRS to reconsider the rule in the proposed regulations, which excludes disgorgement and forfeiture from the definition of “restitution, remediation, and coming into compliance.” One commenter explained the exclusion is contrary to the expressed intent of Congress because the statute provides an exception to the disallowance rule of section 162(f)(1) for restitution and that, in Kokesh, the Supreme Court stated, “[g]enerally, disgorgement is a form of [r]estitution measured by the defendant’s wrongful gain.” Kokesh, 137 S. Ct. at 1640. Commenters noted that, in Liu v. Securities and Exchange Commission, 140 S. Ct. 1936 (2020), which was decided after the publication of the proposed regulations, the Supreme Court recognized that, amounts paid through disgorgement that do not exceed the wrongdoer’s net profits and that are awarded to individual victims may constitute an equitable remedy. Commenters also noted that, in Liu, the Supreme Court expressly declined to answer whether under Kokesh disgorgement necessarily constitutes a penalty. Liu, 140 S. Ct. at 1946.

In consideration of the comments submitted with respect to disgorgement and the Supreme Court’s decision in Liu, the final regulations will not treat disgorgement of net profits as, per se, nondeductible under section 162(f)(1). Instead, taxpayer’s claim for a deduction for amounts paid or incurred through disgorgement will not be disallowed if the amount is otherwise deductible under chapter 1; the order or agreement identifies the payment, not in excess of net profits, as restitution, remediation, or an amount paid to come into compliance with a law; the taxpayer establishes that the amount was paid as restitution, remediation, or an amount paid to come into compliance with a law; and the origin of the taxpayer’s liability is restitution,

remediation, or an amount paid to come into compliance with a law. However, amounts paid or incurred through disgorgement will be disallowed if, pursuant to the order or agreement, the amounts are disbursed to the general account of the government or governmental entity for general enforcement efforts or other discretionary purposes. The final regulations provide an example to illustrate the application of section 162(f) to disgorgement.

Commenters also requested that the Treasury Department and the IRS reconsider the rule in the proposed regulations that excludes forfeiture from the definition of “restitution, remediation, and coming into compliance,” but did not address forfeiture independently from their discussion of disgorgement. Virtually all states have some form of asset recovery legislation and the United States Code contains many forfeiture provisions. Because the final regulations cannot provide specific rules about the application of section 162(f) to every asset recovery statute, the final regulations will not treat forfeiture of net profits as, *per se*, nondeductible under section 162(f)(1). Instead, taxpayer’s claim for a deduction for an amount paid or incurred through forfeiture will not be disallowed if the amount is otherwise deductible under chapter 1; the order or agreement identifies the payment, not in excess of net profits, as restitution, remediation, or an amount paid to come into compliance with a law; the taxpayer establishes that the amount was paid as restitution, remediation, or an amount paid to come into compliance with a law; and the origin of the taxpayer’s liability is restitution, remediation, or an amount paid to come into compliance with a law. However, amounts paid or incurred through forfeiture will be disallowed if, pursuant to the order or agreement, the amounts are disbursed to the general account of the government or

governmental entity for general enforcement efforts or other discretionary purposes.

The final regulations provide an example to illustrate the application of section 162(f) to forfeiture.

d. Payment to a fund

Under the proposed regulations, restitution, remediation, and amounts paid to come into compliance with a law do not include any amount paid or incurred to an entity; to a fund, including a restitution, remediation, or other fund; to a group; or to a government or governmental entity, to the extent it was not harmed by the taxpayer's violation or potential violation of a law. Commenters asked that the Treasury Department and the IRS reconsider this rule. In consideration of the comments, the final regulations remove the per se exclusion. However, the final regulations provide that restitution and remediation do not include amounts paid or incurred pursuant to an order or agreement to the general account or treasury of the government or governmental entity for general enforcement efforts or other discretionary purposes or amounts paid or incurred that do not meet the requirements of §1.162-21(e)(4)(i). In addition, the final regulations provide that if amounts paid or incurred pursuant to an order or agreement to an entity, fund, group, or government or governmental entity are subsequently returned to the taxpayer, the taxpayer will be required to include those amounts in income under the tax benefit rule.

Several commenters noted that restitution funds may not be exhausted if, for example, there are unclaimed amounts or when less than the entire fund is required to be used to make harmed parties whole. One commenter recommended that the final regulations provide an example to illustrate that when unclaimed amounts revert to a

government or governmental entity's general account the nature of those amounts does not change as long as it was reasonably expected, at the time the taxpayer made the payment to the fund, that the amount would be used for restitution payments to harmed consumers. Although the final regulations do not provide this example, the Treasury Department and the IRS generally agree that, if the order or agreement identifies the payment to a fund, described in §1.162-21(e)(4)(A) or (e)(4)(B), as restitution or remediation, and the taxpayer establishes that it made the payment to a fund for the purpose identified, for example, by providing the canceled check making the payment to the fund, a deduction will not be disallowed if, after the taxpayer makes the payment, the amount paid to the fund is not used for the purpose identified as long as the amount does not revert to the taxpayer or for the benefit of the taxpayer.

## 2. Coming into compliance with a law

The proposed regulations provide that an amount is paid or incurred to come into compliance with a law by performing specific services, taking a specific corrective action, providing specific property, or a combination thereof. The final regulations also list amounts that will not be treated as paid or incurred to come into compliance with a law. The final regulations clarify that the services performed, actions taken, and the provision of property must be done to come into compliance with the law that has been violated, or potentially violated.

One commenter requested that the final regulations treat amounts paid or incurred pursuant to an order or agreement to upgrade equipment or property to a higher standard than required by law as coming into compliance with a law. The final regulations modify an example in the proposed regulations to clarify that if an order or

agreement requires a taxpayer to come into compliance with a law and the taxpayer elects to upgrade equipment or property to a higher than required standard, any amount paid or incurred in excess of the amount paid or incurred to come into compliance with a law will not be disallowed by section 162(f)(1) or the related final regulations because it is not an amount paid or incurred to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry into the potential violation of any law.

Another commenter requested that the final regulations define the class of services and actions that qualify as having been made to come into compliance with a law under section 162(f)(2)(A)(i)(II). The final regulations do not adopt this recommendation because they are intended to provide broad rules of general application based on the underlying principles of section 162(f) rather than narrow rules with limited application that risk excluding certain services or actions. The commenter also suggested that the government or governmental entity not be required to verify the accuracy of the amount expended by a taxpayer to perform the activities to come into compliance. The regulations do not require the government or governmental entity to verify the accuracy of the amount expended by a taxpayer to perform the activities to come into compliance.

### 3. Identification requirement

Section 162(f)(2)(A)(ii) requires an order or agreement to identify an amount paid or incurred as restitution, remediation, or to come into compliance with a law. Under the proposed regulations, an order or agreement identifies a payment by stating the nature

of, or purpose for, each payment each taxpayer is obligated to pay and the amount of each payment identified.

To satisfy the identification requirement, the proposed regulations require the order or agreement to specifically state the amount of the payment and that the payment constitutes restitution, remediation, or an amount paid to come into compliance with a law. The proposed rule provides that the identification requirement may be met if the order or agreement uses a different form of the requisite words, such as “remediate” or “comply with a law.”

The Treasury Department and the IRS received several recommendations and requests for clarification regarding how orders or agreements may meet the identification requirement when the payment amount is not identified. One commenter suggested that, if the total amount to be paid is known at the time the agreement is entered into or the order is issued, the order or agreement must identify separately the amount to be paid as restitution, remediation, or to come into compliance with a law in order to meet the identification requirement. In contrast, several other commenters asked whether the identification requirement may be met if the order or agreement identifies the total payment as restitution, remediation, or paid to come into compliance with a law without allocating the payment amount among “restitution,” “remediation,” and “coming into compliance.” Some commenters expressed the concern that it may not be possible to satisfy the identification requirement in an order or agreement that imposes lump-sum judgments or settlements, involves multiple taxpayers, or multiple damage awards, because the order or agreement may not segregate the amounts to be

paid as restitution, remediation, or to come into compliance with a law from the disallowed amounts, or allocate the payments among the multiple taxpayers.

The final regulations do not adopt a rule that a total payment amount must be allocated in an order or agreement among “restitution,” “remediation,” and/or “coming into compliance” in order to meet the identification requirement under section 162(f)(2)(A)(ii) because it could be burdensome on governments and governmental entities and taxpayers and would be difficult for the IRS to administer. Instead, the final regulations modify the proposed rule for payment amounts not identified so that it applies to orders or agreements that impose lump-sum payment judgments for “restitution, remediation, and coming into compliance,” or that involve multiple taxpayers or multiple damage awards. The payment amount not identified rule provides that the identification requirement may be met even if the order or agreement does not allocate the total lump-sum payment amount or multiple damage award among restitution, remediation, or to come into compliance or allocate the total payment among multiple taxpayers. The final regulations also clarify that the identification requirement may be met even if the order or agreement does not provide an estimated payment amount.

Several commenters asked for clarification about how a taxpayer may meet the identification requirement. Consistent with section 162(f)(2)(A)(ii), the final regulations provide that the order or agreement, not the taxpayer, must meet the identification requirement with language specifically stating, or describing, that the amount will be paid or incurred as restitution, remediation, or to come into compliance with a law.

Under the proposed regulations, the identification requirement is presumed to be met if an order or agreement specifically states that the payment, and the amount of the payment, constitutes restitution, remediation, or an amount paid to come into compliance with a law. Commenters requested that the final regulations adopt a more permissive rule pursuant to which the identification requirement is presumed to be met if the order or agreement uses words other than “restitution,” “remediation” or “remediate,” and “come into compliance”, or “comply.” In addition, a commenter also asked for a more permissive rule if an order or agreement is in a foreign language. The final regulations provide that the identification requirement is met, not presumed to be met, if the order or agreement specifically states that the payment constitutes restitution, remediation, or an amount paid to come into compliance with a law. In response to the comments, the final regulations also provide a similar result if the order or agreement uses a different form of the required words, such as, “remediate” or “comply with a law.” An order or agreement in a foreign language may meet the identification requirement if the taxpayer provides a complete and accurate certified English translation of the order or agreement that describes the nature and purpose of the payment using the foreign language equivalent of restitution, remediation, or coming into compliance with the law.

An order or agreement will also meet the identification requirement, despite not using the words “restitution,” “remediation,” “remediate,” “come into compliance”, or “comply,” if the nature and purpose of the payment, as described in the order or agreement, are clearly and unambiguously to restore the injured party or property or to correct the non-compliance. The final regulations provide that an order or agreement will also meet the identification requirement if the order or agreement describes the

damage done, harm suffered, or manner of noncompliance with a law, and describes the action required of the taxpayer to (i) restore, in whole or in part, the party, property, environment, wildlife, or natural resources harmed, injured, or damaged by the violation or potential violation of that law or (ii) to perform services, take action, provide property, or doing any combination thereof to come into compliance with that law.

The proposed regulations provide that the IRS may challenge an order or agreement's identification of the payment amount as restitution, remediation, or made to come into compliance with a law for the purposes of meeting the identification requirement. One commenter recommended that a substantive challenge to the characterization of a payment would more appropriately fit under the establishment requirement, rather than under the identification requirement. To address this comment, the identification requirement in the final regulations does not include a rebuttable presumption.

#### 4. Establishment requirement

Section 162(f)(2)(A)(i) requires that a taxpayer establish that an amount was paid as restitution or remediation, or that the amount was paid to come into compliance with a law. The proposed regulations provide that the taxpayer may satisfy the establishment requirement by providing documentary evidence (1) that the taxpayer was legally obligated to pay the amount the order or agreement identified as restitution, remediation, or to come into compliance with a law; (2) of the amount paid or incurred; and (3) of the date on which the amount was paid or incurred. A commenter recommended that the final regulations clarify what the taxpayer must prove to meet the establishment requirement. The commenter also advised that it would be more

appropriate for the IRS to challenge the characterization of the payment amount as restitution, remediation, or made to come into compliance with a law under the establishment requirement rather than under the identification requirement. The final regulations clarify that the establishment requirement is met if the documentary evidence submitted by the taxpayer proves that the taxpayer was legally obligated to pay the amount identified in the order or agreement as restitution, remediation, or to come into compliance with a law and that it was paid or incurred for the nature and purpose identified.

If the order or agreement identifies a lump sum payment or a multiple damage award that includes some combination of restitution, remediation, and coming into compliance with a law, the taxpayer must establish the exact amount paid or incurred for each purpose. Likewise, if an order or agreement involves multiple taxpayers, each taxpayer must establish the amount that taxpayer paid or incurred as restitution, remediation, or to come into compliance.

The proposed regulations provided a non-exhaustive list of documents that taxpayers may use to satisfy the establishment requirement. Commenters requested that the final regulations include additional examples of such documents. The final regulations expand the list of documentary evidence that may be used to meet the establishment requirement. The taxpayer may be able to use documentary evidence in a foreign language to satisfy the establishment requirement if the taxpayer provides a complete and accurate certified English translation of the documentary evidence.

5. Information return may not satisfy the identification requirement or the establishment requirement

The proposed regulations provide that reporting of the amount by a government or governmental entity under section 6050X does not satisfy the identification requirement or the establishment requirement. A commenter requested that the final regulations provide that a government or governmental entity's submission of an information return under section 6050X can satisfy the identification requirement under section 162(f)(2)(A)(ii) and/or the establishment requirement under section 162(f)(2)(A)(i). The final regulations do not adopt this recommendation. The reporting requirement imposed by section 6050X is for tax administration purposes and does not serve as documentation that the taxpayer has met the identification requirement or the establishment requirement. Therefore, the taxpayer may not use the information reported on the Form 1098-F to satisfy the identification requirement or the establishment requirement.

6. Private party suit

Under section 162(f)(3), the general rule that disallows a deduction does not apply to any amount paid or incurred pursuant to an order in a suit in which no government or governmental entity is a party. Like the proposed regulations, the final regulations clarify that section 162(f)(1) does not apply to any amount paid or incurred by reason of any order or agreement in a suit in which no government or governmental entity is a party. A commenter asked for clarification in the final regulations that section 162(f)(1) does not apply to any amount paid or incurred by reason of any order or agreement in a suit in which a government or governmental entity enforces rights as a private party. For example, payments pursuant to contract disputes that are not due

to fraud or other potentially illegal activity wherein the government or governmental entity enforces its rights as a private party contracting for goods and/or services, and not in its enforcement, regulatory, or administrative capacity, generally are not payments made at the direction of a government or governmental entity. The final regulations generally adopt this recommendation. An example has been provided in the final regulations to illustrate the application of this rule.

A commenter asked for clarification about the application of section 162(f) to qui tam cases brought by private citizens on behalf of a government or governmental entity. The final regulations do not adopt a single rule concerning qui tam cases, but certain principles apply to determine whether a deduction for the amounts paid or incurred will be allowed. In general, a government or governmental entity is the real party in interest in the suit and receives any funds paid pursuant to the order or agreement, including any share ultimately paid by the government or governmental entity to the relator, whether or not the government or governmental entity intervenes in the suit. Accordingly, any amount paid or incurred to a government or governmental entity as a result of the suit will likely be disallowed unless an exception to section 162(f)(1) applies.

#### 7. Pre and postjudgment interest

A commenter asked whether section 162(f)(1) disallows a deduction for prejudgment and postjudgment interest. Section 162(f)(1) applies to prejudgment interest paid or incurred to, or at the direction of, a government or governmental entity for the violation of any law or for the investigation or inquiry into a violation or potential violation of any law. However, a deduction for prejudgment interest will not be

disallowed if the prejudgment interest is identified as a component of the total amount identified in the order or agreement as restitution and the taxpayer establishes that it was paid for this purpose. In general, section 162(f)(1) applies to postjudgment interest on amounts to be paid or incurred to, or at the direction of, a government or governmental entity for the violation of any law or investigation or inquiry into a potential violation of any law. However, if postjudgment interest is paid on an amount to which an exception under section 162(f)(2) applies, the exception also applies to that postjudgment interest.

#### 8. Failure to pay tax and related interest and penalties

The proposed regulations provide that section 162(f)(1) does not apply to amounts paid or incurred as otherwise deductible taxes or related interest. In accordance with section 162(f)(2)(A)(iii), the final regulations provide that, in the case of any amount paid or incurred as restitution for failure to pay any tax imposed under Title 26, section 162(f)(1) does not disallow a deduction for an amount equal to or less than the amount otherwise allowed under chapter 1 if the tax had been timely paid. For example, section 162(f)(1) does not disallow a deduction of an amount paid or incurred as restitution for failure to pay a tax imposed under Title 26 of the Code, such as certain excise or employment taxes otherwise deductible under chapter 1. However, a deduction for amounts paid or incurred as restitution for failure to pay a Federal income tax is disallowed because Federal income taxes are not otherwise deductible under chapter 1. See section 275(a)(1).

The Treasury Department and the IRS received several comments about the application of section 162(f) to federal, state and local taxes, and any related interest

and penalties. Under the proposed regulations, if penalties are imposed with respect to otherwise deductible taxes, a taxpayer may not deduct the interest paid with respect to such penalties. A commenter requested clarification that the taxpayer also may not deduct the penalties. The Treasury Department and the IRS agree and the final regulations are revised accordingly to provide that if penalties are imposed with respect to otherwise deductible taxes, a taxpayer may not deduct the penalties or the interest paid with respect to such penalties.

#### 9. Material change

The proposed regulations contained a material change rule under which some orders issued, or agreements entered, before December 22, 2017, were subject to section 162(f)(1) as amended by the TCJA. Several commenters considered the definition of “material change” in the proposed regulations as “overly broad,” and suggested it could cause unnecessary administrative disputes and discourage taxpayers from negotiating with governments or governmental entities to clarify the terms of an order or agreement, resulting in increased litigation and burdening taxpayers, governments and governmental entities, and courts. One commenter argued that section 13306(a)(2) of the TCJA (the transition rule for section 162(f)) precludes adopting a material change rule for any binding orders issued or agreements entered into before December 22, 2017. The commenter recommended that the final regulations provide that the amendment to section 162(f) applies only to orders issued or agreements entered into after December 22, 2017.

In response to this comment, the Treasury Department and the IRS have determined that section 162(f), as amended by TCJA, does not apply to any pre-

December 22, 2017 binding order or agreement even if modified on or after December 22, 2017. In addition, material changes to an order or agreement will generally result in a new order or agreement subject to section 162(f). For these reasons, the final regulations do not include the material change rule included in the proposed regulations.

## II. Reporting Information for Certain Fines, Penalties, and Other Amounts

### A. General rule

The purpose of the regulations under section 6050X is to provide appropriate officials of governments or governmental entities the operational, administrative, and definitional rules for complying with the statutory information reporting requirements for suits or agreements to which section 6050X(a)(1) applies.

In general, under the final regulations, if the aggregate amount a payor is required to pay pursuant to an order or agreement for a violation, investigation, or inquiry to which section 6050X(a)(1) and (a)(2) applies equals or exceeds the threshold amount, the appropriate official of a government or governmental entity that is a party to the order or agreement must file an information return with the IRS regarding certain amounts paid or incurred pursuant to the order or agreement, the payor's taxpayer identification number (TIN), and other information required by the information return and the related instructions. The appropriate official of a government or governmental entity that is a party to the order or agreement must also furnish a written statement with the same information to the payor.

1. Government, governmental entity, or nongovernmental entity treated as a governmental entity

The proposed regulations provided a definition of “government or governmental entity.” No comments were received on the definition of “government or governmental entity” in the proposed regulations. The definition in the final regulations has been reorganized to provide a definition of a government in §1.6050X-(f)(2) and to provide a definition of a “governmental entity” in §1.162-21(f)(3). The definitions are based on the definition in the proposed regulations but clarify that a political subdivision of a government includes a local government unit. The final regulations also clarify that a governmental entity includes a nongovernmental entity treated as a governmental entity.

The proposed regulations under section 6050X incorporate the definition of a “nongovernmental entity” in the proposed regulations under section 162(f). The final regulations clarify that, for purposes of the information reporting requirements in section 6050X, a nongovernmental entity treated as a governmental entity does not include a nongovernmental entity of a territory of the United States, including American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands, a foreign country, or an Indian tribe.

2. Suit or agreement

The proposed regulations provided that the information reporting is required for a “suit, agreement, or otherwise” pursuant to section 162(f)(1). A commenter noted that this rule is inconsistent with the statutory language of section 6050X, which only concerns a “suit or agreement.” The final regulations clarify that a government or governmental entity involved in a suit or agreement to which section 6050X(a)(2)

applies must file an information return for payment amounts described in section 6050X(a)(1).

Another commenter recommended that the final regulations clarify that a suit or agreement is treated as binding under applicable law even if all appeals have not been exhausted. The final regulations generally adopt this recommendation.

### 3. Payor

The final regulations define “payor” as the person, as defined in section 7701(a)(1), which, pursuant to an order or agreement, has paid or incurred, or is liable to pay or incur, an amount to, or at the direction of, the government or governmental entity in relation to the violation or potential violation of any law. In general, the payor will be the person to which section 162(f) and §1.162-21 apply.

One commenter recommended that the final regulations provide that governments and governmental entities do not have a reporting requirement, and do not need to furnish a written statement, pursuant to section 6050X for the amounts described in section 6050X(a)(1) that tax-exempt, non-profit payors are required to pay. Another commenter recommended that the final regulations provide that the information reporting requirement should apply only for civil, not criminal, cases. A third commenter recommended that the final regulations provide that the information reporting requirement applies only to payors involved in a trade or business and not to individual payors.

The final regulations do not adopt these recommendations because they are inconsistent with section 6050X. Section 6050X does not carve out an exception for criminal cases or individuals, including those not in a trade or business, and tax-exempt

organizations may claim certain chapter 1 deductions, which may be disallowed under section 162(f)(1).

The final regulations require the appropriate official to include the TIN of the payor on the information return filed regarding the payor. Commenters asked how the appropriate official of a government or governmental entity may secure a payor's TIN. If the appropriate official does not already have the payor's TIN, the appropriate official must request the TIN. The TIN may be requested in any manner. The appropriate official must notify the payor that the law requires the payor to furnish a TIN for inclusion on the information return and that failure to furnish the TIN may subject the payor to a penalty under section 6723. The payor may provide the TIN in any manner including orally, in writing, or electronically. If the payor furnishes the TIN in writing, no particular form is required.

#### 4. Threshold amount

Section 6050X(a)(2)(B) provides the Secretary with the authority to adjust the statutory reporting threshold of \$600 as necessary to ensure the efficient administration of the internal revenue laws. Based on comments received prior to the publication of the proposed regulations from governments and governmental entities concerned about the burden of information reporting and to ensure the efficient administration of the internal revenue laws, the Treasury Department and the IRS determined that a threshold higher than \$600 was appropriate to address these concerns. The proposed regulations provided that reporting is required if the aggregate amount of all orders and agreements for the violation, investigation, or inquiry equals or exceeds \$50,000 (threshold amount). Anticipating possible compliance burdens on filers, the Treasury

Department and the IRS requested comments about the proposed \$50,000 threshold. In particular, the Treasury Department and the IRS requested data on the annual number of relevant orders issued, or agreements entered, by governments or governmental entities and the financial, time, and administrative burdens associated with different threshold amounts. After publication of the proposed regulations, the Treasury Department and the IRS received several requests from governments and governmental entities to raise the proposed \$50,000 threshold amount, but none of the comments provided data to support those requests. As a result, the final regulations maintain the proposed threshold amount and provide that reporting is required for payment amounts equal to or in excess of \$50,000.

Commenters described several situations in which the government or governmental entity may be uncertain about its reporting obligation because it is not clear that the suit or agreement requires the payor to make payments described in section 6050X(a)(1) that equal or exceed the threshold amount. In one situation, the order or agreement described in section 6050X(a)(1) requires the payor to make several payments for a violation, investigation, or inquiry, each described in section 6050X(a)(2) and each for less than the threshold amount, but the aggregate amount of all payments pursuant to the order or agreement equals or exceeds the threshold amount. In another situation, an order or agreement involving more than one violation, investigation, or inquiry, each described in section 6050X(a)(2), requires the payor to make several payments, each described in section 6050X(a)(1), and each for less than the threshold amount, but the aggregate amount of all payments pursuant to the order or agreement equals or exceeds the threshold amount.

The commenter recommended that, in these two situations, the final regulations should treat each payment amount separately to determine if the aggregate amount involved in the order or agreement equals or exceeds the threshold amount. The final regulations do not provide rules for every circumstance to which section 6050X(a)(2)(A)(ii) could apply. Form 1098-F and its instructions will contain additional guidance regarding the threshold amount.

Another commenter described a situation in which, pursuant to separate orders or agreements, the payor is required to pay separate amounts, all less than the threshold amount, for multiple acts or omissions in violation of the same law but the aggregate amount of the payments to be made pursuant to all orders and agreements equals or exceeds the threshold amount. The commenter requested that, in this situation, the final regulations treat each order and agreement separately. This situation is addressed by section 6050X(a)(2)(A)(ii), which provides that the government or governmental entity must file an information return for a suit or agreement if “the aggregate amount involved in all court orders and agreements with respect to the violation, investigation, or inquiry” equals or exceeds the threshold amount. Therefore, the final regulations do not adopt the rule proposed by the commenter. The final regulations also provide that in this situation, the appropriate official must file only one information return for all amounts the payor is required to pay pursuant to these orders or agreements.

##### **5. Requirement to file return**

The appropriate official of a government or governmental entity must comply with the information reporting requirements of section 6050X and the related regulations by

filing Form 1098-F, Fines, Penalties, and Other Amounts, or any successor form, as provided by the instructions, with Form 1096, Annual Summary and Transmittal of U.S. Information Returns, on or before the annual due date as provided in the final regulations. Under the final regulations, the information return filed by the government or governmental entity with the IRS must provide the amount a payor is required to pay, pursuant to section 6050X(a)(1)(A) and §1.6050X-1(b)(1)(i), as a result of the order or agreement, the separate amounts required to be paid as restitution, remediation, or to come into compliance with a law, pursuant to section 6050X(a)(1)(B) and (a)(1)(C) and §1.6050X-1(b)(1)(ii), as a result of the order or agreement, the payor's TIN, and any additional information required by the information return and the related instructions.

The Treasury Department and the IRS received comments requesting that the final rules require information reporting only for amounts paid directly to a government or governmental entity. A commenter also requested final rules pursuant to which the government or governmental entity could provide the reporting information to the payor and require the payor to file the information return. None of these suggestions were adopted in the final regulations because they are inconsistent with the explicit language of section 6050X.

A commenter inquired whether the government or governmental entity reports the payment amount identified in the order or agreement, or only the amount the payor ultimately pays. Another commenter recommended that the reporting requirement apply only to payment amounts described in sections 162(f)(1) and 6050X-1(a)(1)(A) that are actually collected by governments and governmental entities.

Section 6050X(a)(1) mandates reporting for “the amount required to be paid as a result

of the suit or agreement” for a violation of any law, or an investigation or inquiry into the potential violation of any law, as well as for restitution, remediation, and to come into compliance with a law. Therefore, the final regulations do not adopt the commenter’s recommendation. Instead, the final regulations clarify that governments and governmental entities have a reporting obligation for the amounts, described in section 6050X(a)(1) and §1.6050X-1(b)(1)(i) and (ii), required to be paid pursuant to the order or agreement.

A commenter inquired whether the IRS would consider using website reporting instead of requiring reporting on a form. Section 6050X prescribes reporting that is more suitable on a form. Furthermore, section 6050X(b) also requires governments and governmental entities to furnish written statements to payors. Thus, even if the final regulations permitted governments and governmental entities to report information to the IRS via a website, they would still need to provide a written statement to payors, which could not be accomplished by a website. To minimize the burden on governments or governmental entities, the final regulations permit the appropriate official to comply with the requirements to furnish written statements to payors via the Form 1098-F or another document that contains the required information if the document conforms to applicable guidance relating to substitute statements.

A commenter expressed concerns about the information reporting requirements resulting from an order or agreement, pursuant to which payments are made over the course of several years. To minimize the burden on governments and governmental entities and to ensure the efficient administration of the internal revenue laws, the final regulations do not require an appropriate official to file information returns for each

taxable year in which a payor makes a payment pursuant to a single order or agreement. Instead, the appropriate official must file only one information return to report the amounts required by section 6050X(a)(1).

Some commenters inquired about the application of the reporting obligation to governments and governmental entities for specific types of administrative and certain other categories of proceedings. The final regulations do not address the application of the reporting obligation to specific statutes or types of proceedings because the final regulations are intended to provide broad rules of general application based on the underlying principles of sections 162(f) and 6050X rather than narrow rules with limited application that risk excluding a certain “violation of any law or the investigation or inquiry . . . into the potential violation of any law.”

One commenter observed that the payors and the governments and governmental entities may have incentives to enter into an agreement concerning the filing of information returns such that payors may improperly attempt to claim deductions to which they are not entitled and governments and governmental entities do not have to incur the burden of filing information returns and furnishing written statements. The commenter recommended that the final regulations treat any agreements between payors and governments or governmental entities not to file information returns as invalid and unenforceable. The final regulations do not adopt this recommendation because section 162(f) applies to the taxpayer regardless of whether the appropriate official files an information return with the IRS and furnishes a written statement to the payor.

## **6. Due dates**

Section 6050X(a)(3) provides that the information return shall be filed at the time the agreement is entered into, as determined by the Secretary, not at the time of payment, as recommended by a commenter. Further, section 6050X(b) requires the written statement to be furnished to the payor at the same time the information return is filed with the IRS. Under the proposed regulations, the information return was required to be filed on or before January 31 of the year following the calendar year in which the order or agreement, becomes binding under applicable law.

A commenter requested that appropriate officials of governments and governmental entities be given more time to comply with the requirement. As requested, the final regulations provide, pursuant to section 6071(a), that information returns filed with the IRS on paper are due on or before February 28 of the year following the calendar year in which the order or agreement, becomes binding under applicable law. In accordance with section 6071(b), information returns filed electronically are due on or before March 31 of such year. However, to increase the likelihood that payors have the information necessary to timely prepare their income tax returns and to avoid burdening governments and governmental entities with having to determine the tax year of each payor, the final regulations require the appropriate official to furnish the written statement on or before January 31 of such year.

## **7. Rules for multiple payors**

The final regulations describe the application of the information reporting requirements if, pursuant to the order or agreement, the aggregate amount multiple payors are required to pay, or the costs to provide the property or the service, equals or

exceeds the threshold amount. If, pursuant to the order or agreement, more than one payor is individually liable for some or all of the payment amount, the final regulations require the appropriate official to file an information return for the separate amount that each individually liable payor is required to pay, even if a payor's payment liability is less than the threshold amount, and to furnish a written statement containing this information to each payor. If more than one person, as defined in section 7701(a)(1), is a party to an order or agreement, there is no information reporting requirement, or requirement to furnish a written statement, with respect to any person who does not have a payment obligation or obligation for costs to provide services or to provide property.

The final regulations provide that, if an order or agreement, identifies multiple jointly and severally liable payors, the appropriate official must file an information return for each payor to report the information required by §1.6050X-1(b)(1)(i) and (ii) on the amount to be paid by all jointly and severally liable payors. The appropriate official must furnish a written statement containing this information to each of those payors, regardless of which payor makes the payment.

A commenter wrote that the rules requiring reporting would be challenging to implement when multiple payors are required to make payments. However, under section 6050X(a)(1)(3), the appropriate official has an obligation to file an information return when an order or agreement becomes binding, not when the payments are made, so there is no need for governments or governmental entities to track the receipt of payments in order to comply with section 6050X or the related final regulations.

Another commenter recommended that the payment obligation of each payor be examined separately to determine whether the amount each payor is required to pay, or

the costs to provide the property or the service, equals or exceeds the threshold amount. However, in the case of joint and several liability, each payor is responsible for the entire amount, which requires reporting of, and furnishing a statement to, each payor. In the case where a payor is individually liable for an amount below the threshold amount, the payor may still attempt to deduct some or all of the payment amount all of the payors are required to pay, so filing an information return for each of the payors' liabilities is useful for tax administration.

One commenter asked for clarification that the government or governmental entity is not obligated to file an information return with the IRS if, after an order or agreement has become binding under applicable law, the payor pursues another party for contribution. Because any payment the payor receives from another party in a subsequent proceeding will not be subject to section 162(f), the government or governmental entity will not have an obligation to file an information return for any payment made by the other party.

#### 8. Payment amount not identified

Commenters expressed concern that it is difficult for governments and governmental entities to estimate the payment amount pursuant to the order or agreement, and whether the aggregate amount equals or exceeds the information reporting threshold, when the order or agreement does not specify an amount. The Treasury Department and the IRS agree, which is why the regulations do not require governments or governmental entities to estimate payment amounts. Accordingly, if some or all of the payment amount is not identified in the order or agreement, the

regulations direct governments and governmental entities to the instructions to Form 1098-F, or any successor form.

Some orders or agreements may identify a payment described in section 6050X(a)(1)(A) and identify a payment or an obligation to provide property or to provide services, as restitution, remediation, or an amount paid to come into compliance with a law, as described in section 6050X(a)(1)(B), but not identify some or all of the payment amounts the payor must pay, or some or all of the cost to provide property or services. The final regulations provide that, if the government or governmental entity reasonably expects that the aggregate amount the payor must pay, and the costs the payor will pay or incur to provide services or to provide property, pursuant to the order or agreement, will equal or exceed the threshold amount, the appropriate official of such government or governmental entity must file an information return on Form 1098-F, or any successor form, as provided in the instructions to the Form 1098-F, and furnish a written statement to the payor with the information supplied to the IRS on Form 1098-F.

Similarly, a commenter noted that some orders or agreements may require a payor to make payments described in section 6050X(a)(1) for which reporting is required and other payments for which reporting is not required under section 6050X. The commenter recommended that if it is not clear for which payment amount the government or governmental entity has a reporting requirement, the rule under the proposed regulations for a payment amount not identified should apply. The Treasury Department and the IRS generally agree with this recommendation. Therefore, if, under the circumstances described by the commenter, the government or governmental entity reasonably expects that the aggregate amount the payor must pay, and the costs the

payor must pay to provide services or to provide property, will equal or exceed the threshold amount, the appropriate official of such government or governmental entity must file an information return.

#### 9. Material change

Under the proposed regulations, if there was a material change to the terms of an order or agreement for which an appropriate official of a government or governmental entity filed an information return, the appropriate official had to file a corrected information return with the IRS and furnish an amended written statement to the payor. The Treasury Department and the IRS have concluded that material changes to an order or agreement will generally result in a new order or agreement subject to the rules under section 6050X and §1.6050X-1. For this reason, and because the final regulations under §1.162-21 do not include a material change rule, the final regulations have removed the material change rule from §1.6050X-1.

#### **Applicability Dates**

The rules of §1.162-21 apply to taxable years beginning on or after the date of publication of this Treasury decision in the **Federal Register**, except that such rules do not apply to amounts paid or incurred under any order or agreement, pursuant to a suit, agreement, or otherwise, that became binding under applicable law before such date, determined without regard to whether all appeals have been exhausted or the time for filing an appeal has expired. The rules of §1.6050X-1 apply only to orders and agreements, pursuant to suits and agreements, that become binding under applicable law on or after January 1, 2022, determined without regard to whether all appeals have been exhausted or the time for filing an appeal has expired.

## **Special Analyses**

### I. Regulatory Planning and Review – Economic Analysis

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

The regulations have been designated by the Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and by the Office of Management and Budget (OMB) regarding review of tax regulations.

#### A. Background

Prior to the Tax Cuts and Jobs Act (TCJA), section 162(f) of the Code disallowed a deduction for any fine or similar penalty paid to a government for the violation of any law. This provision, enacted in 1969, codified existing case law that denied business deductions for fines or similar penalties. The general rule of section 162(f)(1), as amended by section 13306(a) of the TCJA, disallows any deduction for amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity or certain nongovernmental entities treated as governmental entities, 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. Section 13306(a)

also provides certain exceptions to this disallowance. Section 162(f)(2)(A)(i) and (ii) does not disallow deduction for amounts that (1) the taxpayer establishes were paid or incurred as restitution (including remediation of property) or to come into compliance with a law, and (2) are identified in the court order or settlement agreement as restitution, remediation, or to come into compliance with a law.

In addition, under prior law, the Treasury Department and the IRS did not receive information returns from governments or governmental entities that received fines or penalties. Section 6050X of the Code, enacted by section 13306(b) of the TCJA, requires appropriate officials to file an information return if the aggregate amount involved in all orders or agreements relating to the violation, investigation, or inquiry is \$600 or more. The information return must include (1) the amount required to be paid as a result of the order or agreement; (2) any amount that constitutes restitution or remediation of property; and (3) any amount required to be paid for the purpose of coming into compliance with a law that was violated or involved in the investigation or inquiry. Section 6050X provides the Secretary with the authority to adjust the \$600 reporting threshold in order to ensure efficient tax administration.

Proposed regulations regarding these provisions were previously issued on May 13, 2020 (REG-104591-18) (proposed regulations).

#### B. Need for the Regulations

Following the passage of the TCJA, the Treasury Department and the IRS received several questions and comments from Federal, state, local, and tribal governments, as well as the public, regarding the meaning of various provisions in each section and issues not explicitly addressed in the statute. The Treasury Department

and the IRS have determined that such comments warrant the issuance of further guidance.

In addition, the Treasury Department and the IRS have determined that increasing the reporting threshold to reduce the reporting burden and to enhance the efficiency of tax administration is appropriate.

#### C. Overview of the Regulations

The regulations provide guidance regarding sections 162(f) and 6050X. The following analysis provides further detail regarding the anticipated impacts of the regulations. Part I.D specifies the baseline for the economic analysis. Part I.E.1. summarizes the economic effects of the rulemaking, relative to this baseline. Part I.E.2. describes the economic effects of specific provisions covering (1) the reporting threshold, (2) the timing of information reporting, and (3) information reporting requirements when payment amounts are not identified.

#### D. Baseline

In this analysis, the Treasury Department and the IRS assess the benefits and costs of the final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these regulations.

#### E. Economic Analysis of the Regulation

##### I. Summary of Economic Effects

The regulations under section 162(f) provide definitions for restitution, remediation, and amounts paid to come into compliance with the law. These definitions clarify for taxpayers which amounts paid or incurred may be deductible under the

statute. The regulations also clarify (1) how the taxpayer meets the establishment requirement; and (2) how the order or agreement meets the identification requirement.

The Treasury Department and the IRS have determined that the burden reduction associated with the regulations for section 162(f) is modest. In addition, while the regulations reduce uncertainty for taxpayers, they are unlikely to affect economic decision-making because most of the amounts to be paid or incurred which are subject to section 162(f) are non-discretionary.

The regulations under section 6050X provide certainty and consistency for affected governments and governmental entities by defining and clarifying the statute's terms and rules. Further, the regulations use the authority provided by the statute to the Secretary to set information reporting requirements to minimize the burden on governments and governmental entities and to ensure the efficient administration of the internal revenue laws. Most importantly, the regulations increase the reporting threshold from \$600 to \$50,000, thereby eliminating information reporting requirements for approximately 1 to 5 million orders or agreements. Using the midpoint of this range (3 million), the estimated burden reduction from this exercise of regulatory discretion is \$74 million (2018 dollars) per year relative to the no-action baseline.

This reduction in compliance burden is the only meaningful economic effect of the regulations. The regulations do not have meaningful effects on the tax liability of taxpayers, the deductibility of amounts paid to, or at the directions of, governments and governmental entities, or the incentive for individuals or businesses to engage in violations of the law.

## II. Economic Analysis of Specific Provisions

### A. Reporting Threshold

Section 6050X requires governments and governmental entities which enter orders or agreements to which section 162(f) applies to file an information return if the aggregate amount paid or incurred in all orders or agreements relating to the violation, investigation, or inquiry is equal to or exceeds a threshold of \$600. Section 6050X also provides the Secretary with the authority to adjust the statutory reporting threshold as necessary to ensure efficient tax administration. In response to multiple comments received prior to the issuance of the proposed regulations from governments and governmental entities concerned about the burden of information reporting for smaller payments amounts pursuant to orders or agreements, the regulations raise the reporting threshold to \$50,000. In the proposed regulations, the Treasury Department and the IRS solicited data on the annual number of orders or agreements by governments or governmental entities that could inform the determination of the appropriate threshold amount. The Treasury Department and the IRS did not receive any such data.

The Treasury Department and the IRS considered a range of alternative thresholds including the statutory threshold of \$600, along with much higher thresholds suggested by some commenters. Upon consideration of both the enforcement needs of the IRS and the reporting burden on governments and governmental entities, the Treasury Department and the IRS exercised the authority provided to the Secretary by the statute to set the reporting threshold amount at \$50,000.

The Treasury Department and the IRS do not know of any data on the number of orders or agreements requiring taxpayers to pay amounts to, or at the direction of, governments or governmental entities, or the distribution of these amounts, such as the number that are above or below \$600. Based on communications with stakeholders, the Treasury Department and the IRS estimate that the increase in reporting threshold from \$600 to \$50,000 will reduce the number of required information returns by approximately 1 to 5 million. The Treasury Department and the IRS further estimate that the average time to complete the information return is between 0.387 and 0.687 hours. Using the midpoint of each of these ranges (3 million information returns and .537 hours) and a labor cost of \$46 per hour,<sup>1</sup> the Treasury Department and the IRS estimate that increasing the reporting threshold will reduce annual compliance burdens by \$74 million dollars (2018 dollars) per year. It should be noted that many of the lower level fines and penalties are likely to be assessed on non-businesses that are not able to deduct business expenses so they would be unaffected by the extent to which governments or governmental entities are subject to reporting requirements.

Increasing the reporting threshold from \$600 to \$50,000 is unlikely to have a significant effect on revenues because fines over \$50,000 likely account for the vast majority of fines and penalties in terms of dollar values. Based on financial reporting values disclosed on tax returns of C corporations, S corporations and partnerships, firms with over \$50,000 in total fines and penalties account for 99 percent of all fines and penalties. However, these data should be interpreted with caution. Financial reporting of fines and penalties includes both international and domestic fines, and all

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<sup>1</sup> This data point is derived by the IRS as part of the burden analysis described in the Paperwork Reduction Act section below.

fines and penalties are aggregated into yearly totals. Furthermore, firms with less than \$10 million in assets are not required to provide financial reporting values with their tax returns.

#### B. Time of Reporting

Section 6050X provides that the government or governmental entity shall file the information return at the time the order is issued or the agreement is entered into, as determined by the Secretary. The Treasury Department and the IRS received comments from governments and governmental entities prior to the issuance of the proposed regulations observing that it would be burdensome and inefficient for them to file information returns each time an order or agreement becomes binding under applicable law. Several commenters suggested that annual filing of information returns would meaningfully reduce this reporting burden. The Treasury Department and the IRS agree with this comment and have adopted it in the regulations. The Treasury Department and the IRS have not estimated the difference in compliance burden between these two alternatives because they do not have suitable data or models to do so.

Several commenters also expressed uncertainty and concern about the information reporting requirements for an order or agreement pursuant to which payments are made over the course of several years. To reduce uncertainty, and to minimize the burden on governments and governmental entities, the regulations clarify that information reporting is required only for the year in which the order or agreement becomes binding under applicable law, and not required for each taxable year in which a payor makes a payment.

The Treasury Department and the IRS considered requiring information reporting at the time the order is issued or the agreement is entered. The Treasury Department and the IRS also considered requiring information reporting in each year in which an amount is paid or incurred pursuant to the order or agreement. However, both alternative approaches were determined to impose unnecessary burden for governments and governmental entities without creating accompanying benefits for tax administration or for taxpayers.

Under the proposed regulations, the information return was required to be filed with the IRS, and a written statement furnished to the payor, on or before January 31 of the year following the calendar year in which the order or agreement becomes binding under applicable law, even if all appeals have not been exhausted for the suit or agreement. In response to the proposed regulations, a commenter requested that governments and governmental entities be given more time to comply with the requirements. As requested, the final regulations are revised to provide that information returns filed with the IRS on paper are due on or before February 28 of the year following the calendar year in which the order or agreement becomes binding under applicable law and information returns filed electronically are due on or before March 31 of such year. However, to increase the likelihood that payors have the information necessary to timely prepare their income tax returns, the final regulations still require governments and governmental entities to furnish the written statements to payors on or before January 31 of such year.

### C. Payment Amount Not Identified

When the expected amount paid or incurred pursuant to an order or agreement equals or exceeds the threshold amount, section 6050X requires governments or governmental entities to file an information return including: (1) the amount required to be paid as a result of the order or agreement; (2) any amount that constitutes restitution or remediation of property; and (3) any amount required to be paid for the purpose of coming into compliance with a law that was violated or involved in the investigation or inquiry. However, some orders or agreements may involve uncertain payments or costs to provide property or services without identifying some or all of the aggregate amount the payor must pay, or some or all of the aggregate cost to provide property or services.

The Treasury Department and the IRS received comments expressing concern that amounts paid or incurred are often difficult to assess, and strict valuation requirements would impose undue burden on governments and governmental entities. For situations in which the amount is not identified, the regulations direct governments and governmental entities to the instructions to Form 1098-F. To address commenters' concerns, these instructions will permit governments and governmental entities to report the threshold amount of \$50,000 when the amount is unknown but expected to equal or exceed \$50,000. This rule is necessary to improve taxpayer compliance.

The Treasury Department and the IRS considered requiring governments and governmental entities to provide an estimate of each amount to be paid or incurred; however this approach was rejected because it would impose significant burden on governments and governmental entities. The Treasury Department and the IRS did not

estimate the difference in compliance burden between the final regulation and this alternative approach because they do not have suitable data or models to do so.

## **Paperwork Reduction Act**

### Collection of Information – Form 1098-F

In general, the collection of information in the regulations is required under section 6050X of the Code. The collection of information in these regulations is set forth in §1.6050X-1. The IRS intends that the collection of information pursuant to section 6050X will be conducted by way of Form 1098-F, Fines, Penalties, and Other Amounts. Form 1098-F will be used by all governments, governmental entities, and nongovernmental entities treated as governmental entities with a reporting requirement. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the regulations. In addition, when available, drafts of IRS forms are posted for comment at [www.irs.gov/draftforms](http://www.irs.gov/draftforms).

The current status of the PRA submissions related to section 6050X are provided in the following table.

<b>Form</b>	<b>Type of Filer</b>	<b>OMB Number</b>	<b>Status</b>
1098-F	Governments, Governmental Entities, And Certain Nongovernmental Entities	1545-2284	Form 1098-F is approved through 1/31/2023.

### Related New or Revised Tax Forms

	<b>New</b>	<b>Revision of Existing Form</b>	<b>Number of Respondents (2018, estimated)</b>
Form 1098-F	Yes		90,100 (85,500 small governmental jurisdictions, 4,500 large governmental jurisdictions and 100 nongovernmental entities).

A reasonable burden estimate for the average time to complete Form 1098-F is between 0.387 and 0.687 hours (approximately 23 to 41 minutes). This estimate is based on survey data collected from similar information return filers. In addition, the increase in the reporting threshold under section 6050X will lead to a decrease in the number of information returns filed by approximately 1 million to 5 million returns. Using the midpoint of these ranges, or 3 million and 0.537 hours, the estimated burden reduction is \$74 million per year.

Estimated average time per form: .537 hours.

Estimated number of respondents: 90,100.

Estimated total annual burden hours: 48,383.70.

Estimated change in number of information returns resulting from increased reporting threshold: (3,000,000).

Estimated change in burden (hours): (1,611,150).

Estimated change in burden (Dollars): (\$74,161,235).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## **Regulatory Flexibility Act**

The Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6) requires agencies to “prepare and make available for public comment an initial regulatory flexibility analysis,” which will “describe the impact of the rule on small entities.” 5 U.S.C. 603(a). Section 605(b) of the RFA allows an agency to certify a rule if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

Pursuant to the RFA, the Secretary of the Treasury hereby certifies that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the RFA.

The RFA generally applies to regulations that affect small businesses, small organizations, and small governmental jurisdictions. For purposes of the RFA, small governmental jurisdictions are governments of cities, counties, towns, townships, villages, school districts, or special districts with a population of less than 50,000. This rule would affect States, as well as local governments, some of which may meet the definition of small governmental jurisdiction. Approximately 90,100 governments, governmental entities, and nongovernmental entities treated as governmental entities may be subject to the reporting requirements of section 6050X. Of those governments and governmental entities, approximately 85,500 (or 95%) are small governmental jurisdictions.

Although the regulations may affect a substantial number of small governmental jurisdictions, the economic impact of the regulations is not expected to be significant. The regulations set a reporting threshold that is higher than the minimum required by

statute and also provide for governments and governmental entities to file annual returns. Both of these provisions reduce the potential burden on small governmental jurisdictions. In particular, the increase in the reporting threshold will lead to a decrease in the number of information returns filed by approximately 1 million to 5 million returns. Using the midpoint of this range, or 3 million, the estimated burden reduction is \$74 million per year (2018 dollars). It is estimated that after reading and learning about the requirements of the regulations, the burden associated with filing the annual form is approximately 23 to 41 minutes and the average cost per information return is approximately \$24.72, which would not result in a significant economic impact on small entities.

Pursuant to section 7805(f) of the Code, the proposed rule preceding this rulemaking was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small entities and no comments were received.

### **Unfunded Mandates Reform Act**

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

## **Executive Order 13132: Federalism**

Executive Order 13132 (entitled Federalism) prohibits an agency from publishing any rule that has Federalism implications if the rule either imposes substantial direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These rules do not have Federalism implications, and do not impose substantial direct compliance costs on state and local governments or preempt state law, within the meaning of the Executive Order. The compliance costs, if any, are imposed on state and local governments by section 6050X, as enacted by the TCJA. Notwithstanding, the Treasury Department and the IRS consulted with the National League of Cities and the National Governors Association prior to the issuance of the proposed regulations. Pursuant to the requirements set forth in section 8(a) of Executive Order 13132, the Treasury Department and the IRS certify that they have complied with the requirements of Executive Order 13132.

## **Congressional Review Act**

The Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget has determined that this is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 et seq.) (CRA)). Under 5 U.S.C. 801(3), a major rule takes effect 60 days after the rule is published in the **Federal Register**.

Notwithstanding this requirement, 5 U.S.C. 808(2) allows agencies to dispense with the requirements of 5 U.S.C. 801 when the agency for good cause finds that such procedure would be impracticable, unnecessary, or contrary to the public interest and the rule shall take effect at such time as the agency promulgating the rule determines.

Pursuant to 5 U.S.C. 808(2), the Treasury Department and the IRS find, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest.

Following the amendments to section 162(f) and enactment of section 6050X by the TCJA, the Treasury Department and the IRS published IRS published Notice 2018–23, 2018–15 I.R.B. 474, to provide transitional guidance on the identification requirement of section 162(f) and the information reporting requirement under section 6050X and to solicit comments from the public and affected governments and governmental entities on issues related to the implementation of section 162(f) and section 6050X. Subsequently, on May 13, 2020, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-104591-18) in the **Federal Register** (85 FR 28524) providing additional guidance for taxpayers and governments and governmental entities on the deduction disallowance rules in section 162(f) and the associated reporting requirements in section 6050X. However, as demonstrated by the wide variety of public comments in response to the proposed regulations received, taxpayers and governments and governmental entities continue to express uncertainty regarding the proper application of the relevant statutory rules under section 162(f) and section 6050X. These final regulations provide crucial guidance for taxpayers and governments and governmental entities on how to apply the relevant statutory rules. In certain cases, failure to comprehend the proper application of the requirements of section 162(f) can prevent taxpayers from claiming appropriate deductions, resulting in them paying potentially higher taxes than required during a time of economic difficulty.<sup>2</sup>

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<sup>2</sup> See Executive Order 13924 (May 19, 2020) 85 FR 31,353-54.

In addition, governments and governmental entities will require several months to update or develop data collection and reporting systems to comply with the rules under section 6050X. However, governments and governmental entities will need to know that the final regulations are effective before incurring necessary costs to timely comply with the final regulations. Accordingly, the Treasury Department and the IRS have determined that the rules in this Treasury decision will take effect on the date of filing for public inspection in the **Federal Register**.

### **Statement of Availability of IRS Documents**

IRS Revenue Procedures, Revenue Rulings, Notices and other guidance cited in this document are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

### **Drafting Information**

The principal author of these regulations is Sharon Y. Horn of Associate Chief Counsel (Income Tax and Accounting), IRS. However, other personnel from the Treasury Department and the IRS participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes; Reporting and recordkeeping requirements

### **Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

## **PART 1—INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.6050X-1 also issued under 26 U.S.C. 6050X(a), (b).

\* \* \* \* \*

Par. 2. Section 1.162-21 is revised to read as follows:

§1.162-21 Denial of deduction for certain fines, penalties, and other amounts.

(a) Deduction Disallowed. Except as otherwise provided in this section, no deduction is allowed under chapter 1 of the Internal Revenue Code (Code) for any amount that is paid or incurred--

(1) By suit, settlement agreement (agreement), or otherwise, as defined in paragraph (e)(5) of this section;

(2) To, or at the direction of, a government, as defined in paragraph (e)(1) of this section, or a governmental entity, as defined in paragraph (e)(2) of this section; and

(3) In relation to the violation, or investigation or inquiry by such government or governmental entity into the potential violation, of any civil or criminal law.

(i) An amount that is paid or incurred in relation to the violation of any civil or criminal law includes a fine or penalty.

(ii) An investigation or inquiry into the potential violation of any law does not include routine investigations or inquiries, such as audits or inspections, of regulated businesses that are not related to any evidence of wrongdoing or suspected wrongdoing, but are conducted to ensure compliance with the rules and regulations applicable to those businesses.

(b) Exception for restitution, remediation, and amounts paid to come into compliance with a law--(1) In general. Paragraph (a) of this section does not apply to

amounts paid or incurred for restitution (including remediation) or to come into compliance with a law, as defined in paragraphs (e)(4) of this section, provided that both the identification and the establishment requirements of paragraphs (b)(2) and (b)(3) of this section are met.

(2) Identification requirement--(i) In general. A court order (order) or an agreement, as defined in paragraph (e)(5) of this section, identifies a payment by stating the nature of, or purpose for, each payment each taxpayer is obligated to pay and the amount of each payment identified.

(ii) Meeting the identification requirement. The identification requirement is met if an order or agreement specifically states the amount of the payment described in paragraph (b)(2)(i) of this section and that the payment constitutes restitution, remediation, or an amount paid to come into compliance with a law. If the order or agreement uses a different form of the required words (such as "remediate" or "comply with a law") and describes the purpose for which restitution or remediation will be paid or the law with which the taxpayer must comply, the order or agreement will be treated as stating that the payment constitutes restitution, remediation, or an amount paid to come into compliance with a law. Similarly, if an order or agreement specifically describes the damage done, harm suffered, or manner of noncompliance with a law and describes the action required of the taxpayer to provide restitution, remediation, or to come into compliance with any law, as defined in paragraph (e)(4) of this section, the order or agreement will be treated as stating that the payment constitutes restitution, remediation, or an amount paid to come into compliance with any law. Meeting the

establishment requirement of paragraph (b)(3) of this section alone is not sufficient to meet the identification requirement of paragraph (b)(2) of this section.

(iii) Payment amount not identified.

(A) If the order or agreement identifies a payment as restitution, remediation, or to come into compliance with a law but does not identify some or all of the amount the taxpayer must pay or incur, the identification requirement may be met for any payment amount not identified if the order or agreement describes the damage done, harm suffered, or manner of noncompliance with a law, and describes the action required of the taxpayer, such as paying or incurring costs to provide services or to provide property.

(B) If the order or agreement identifies a lump-sum payment or multiple damages award as restitution, remediation, or to come into compliance with a law but does not allocate some or all of the amount the taxpayer must pay or incur among restitution, remediation, or to come into compliance with a law, or does not allocate the total payment amount among multiple taxpayers, the identification requirement may be met for any payment amount not specifically allocated if the order or agreement describes the damage done, harm suffered, or manner of noncompliance with a law, and describes the action required of the taxpayer, such as paying or incurring costs to provide services or to provide property.

(3) Establishment requirement--(i) Meeting the establishment requirement. The establishment requirement is met if the taxpayer, using documentary evidence, proves the taxpayer's legal obligation, pursuant to the order or agreement, to pay the amount identified as restitution, remediation, or to come into compliance with a law; the amount

paid or incurred; the date the amount was paid or incurred; and that, based on the origin of the liability and the nature and purpose of the amount paid or incurred, the amount the taxpayer paid or incurred was for restitution or remediation, as defined in paragraph (e)(4)(i) of this section or to come into compliance with any law, as defined in paragraph (e)(4)(ii) of this section. If the amount is paid or incurred to a segregated fund or account, as described in paragraphs (e)(4)(i)(A)(II) and (III), (e)(4)(i)(B), or (e)(4)(i)(C) of this section, the taxpayer may meet the establishment requirement even if each ultimate recipient, or each ultimate use, of the payment is not designated or is unknown. A taxpayer will not meet the establishment requirement if the taxpayer fails to prove that the taxpayer paid or incurred the amount identified as restitution, remediation, or to come into compliance with a law; the amount paid; the date the amount was paid or incurred; or that the amount the taxpayer paid or incurred was for the nature and purpose identified in the order or agreement as required by paragraph (b)(2)(i) of this section, or was made for the damage done, harm suffered, noncompliance, or to provide property or services as described in (b)(2)(iii) of this section. Meeting the identification requirement of paragraph (b)(2) of this section is not sufficient to meet the establishment requirement of paragraph (b)(3) of this section.

(ii) Substantiating the establishment requirement. The documentary evidence described in paragraph (b)(3)(i) of this section includes, but is not limited to, receipts; the legal or regulatory provision related to the violation or potential violation of any law; documents issued by the government or governmental entity relating to the investigation or inquiry, including court pleadings filed by the government or governmental entity requesting restitution, remediation, or demanding that defendant take action to come

into compliance with the law; judgment; decree; 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, determined without regard to whether all appeals have been exhausted or the time for filing an appeal has expired.

(c) Other exceptions--(1) Suits between private parties. Paragraph (a) of this section does not apply to any amount paid or incurred by reason of any order or agreement in a suit in which no government or governmental entity is a party or any order or agreement in a suit pursuant to which a government or governmental entity enforces its rights as a private party.

(2) Taxes and related interest. Paragraph (a) of this section does not apply to amounts paid or incurred as otherwise deductible taxes or related interest. However, if penalties are imposed relating to such taxes, paragraph (a) of this section applies to disallow a deduction for such penalties and interest payments related to such penalties.

(3) Failure to pay title 26 tax. In the case of any amount paid or incurred as restitution for failure to pay tax imposed under title 26 of the United States Code, paragraph (a) of this section does not disallow a deduction for title 26 taxes, such as excise and employment taxes, which are equal to or less than the deduction otherwise allowed under chapter 1 of the Code if the tax had been timely paid.

(d) Application of general principles of Federal income tax law--(1) Taxable year of deduction. If, under paragraph (b) or (c) of this section, the taxpayer is allowed a deduction for the amount paid or incurred pursuant to an order or agreement, the deduction is taken into account under the rules of section 461 and the related

regulations, or under a provision specifically applicable to the allowed deduction, such as §1.468B-3(c).

(2) Tax benefit rule applies. If the deduction allowed under paragraphs (b) or (c) of this section results in a tax benefit to the taxpayer, the taxpayer must include in income, under sections 61 and 111, the recovery of any amount deducted in a prior taxable year to the extent the prior year's deduction reduced the taxpayer's tax liability.

(i) A tax benefit to the taxpayer includes a reduction in the taxpayer's tax liability for a prior taxable year or the creation of a net operating loss carryback or carryover.

(ii) A taxpayer's recovery of any amount deducted in a prior taxable year includes, but is not limited to--

- (A) Receiving a refund, recoupment, rebate, reimbursement, or otherwise recovering some or all of the amount the taxpayer paid or incurred, or
- (B) Being relieved of some or all of the payment liability under the order or agreement.

(e) Definitions. For section 162(f) and §1.162-21, the following definitions apply:

(1) Government. A government means--

(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 (such as a local government unit) of a government described in paragraph (e)(1)(i), (ii), or (iii) of this section.

(2) Governmental entity. A governmental entity means--

- (i) A corporation or other entity serving as an agency or instrumentality of a government (as defined in paragraph (e)(1) of this section), or
- (ii) A nongovernmental entity treated as a governmental entity as described in paragraph (e)(3) of this section.

(3) Nongovernmental entity treated as a governmental entity. A nongovernmental entity treated as a governmental entity is an entity that--

- (i) Exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange, as defined in section 1256(g)(7); or
- (ii) Exercises self-regulatory powers, including adopting, administering, or enforcing rules and imposing sanctions, as part of performing an essential governmental function.

(4) Restitution, remediation of property, and amounts paid to come into compliance with a law--(i) Amounts for restitution or remediation. An amount is paid or incurred for restitution or remediation pursuant to paragraph (b)(1) of this section if it is paid or incurred to restore, in whole or in part, the person, as defined in section 7701(a)(1); government; governmental entity; property; environment; wildlife; or natural resources harmed, injured, or damaged by the violation or potential violation of any law described in paragraph (a)(3) of this section to the same or substantially similar position or condition as existed prior to such harm, injury or damage.

(A) Environment, wildlife, or natural resources. Restitution or remediation of the environment, wildlife, or natural resources includes amounts paid or incurred for the purpose of conserving soil, air, or water resources, protecting or restoring the environment or an ecosystem, improving forests, or providing a habitat for fish, wildlife, or plants. The amounts must be paid or incurred--

- (I) To, or at the direction of, a government or governmental entity to be used exclusively for the restitution or remediation of a harm to the environment, wildlife, or natural resources;
- (II) To a segregated fund or account established by a government or governmental entity and, pursuant to the order or agreement, the amounts are not disbursed to the general account of the government or governmental entity for general enforcement efforts or other discretionary purposes; or
- (III) To a segregated fund or account established at the direction of a government or governmental entity.
- (IV) Paragraph (e)(4)(i)(A) of this section applies only if there is a strong nexus or connection between the purpose of the payment and the harm to the environment, natural resources, or wildlife that the taxpayer has caused or is alleged to have caused.

(B) Disgorgement or forfeiture. Provided the identification and establishment requirements of paragraphs (b)(2) and (b)(3) of this section are met, restitution may include amounts paid or incurred as disgorgement or forfeiture, if paid or incurred at the direction of a government or governmental entity directly to the person, as defined in section 7701(a)(1), harmed by the violation or potential violation of any law or to, or at the direction of, the government or governmental entity, to establish a segregated fund

or account for the benefit of such harmed person. This paragraph (e)(4)(i)(B) does not apply if the order or agreement identifies the payment amount as in excess of the taxpayer's net profits or, pursuant to the order or agreement, the amounts are disbursed to the general account of the government or governmental entity for general enforcement efforts or other discretionary purposes.

(C) Segregated funds or accounts. Provided the identification and establishment requirements of paragraphs (b)(2) and (b)(3) of this section are met, restitution or remediation may include amounts paid or incurred, pursuant to an order or agreement, to a segregated fund or account to restore, in whole or in part, the person, as defined in section 7701(a)(1); government; governmental entity; property; environment; wildlife; or natural resources harmed, injured, or damaged by the violation or potential violation of any law described in paragraph (a)(3) of this section. This paragraph (e)(4)(i)(C) does not apply if, pursuant to the order or agreement, the amounts are disbursed to the general account of the government or governmental entity for general enforcement efforts or other discretionary purposes.

(ii) Amounts to come into compliance with a law. 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 to come into compliance with that law.

(iii) Amounts not included. Regardless of whether the order or agreement identifies them as such, restitution, remediation, and amounts paid to come into compliance with a law do not include any amount paid or incurred--

(A) As reimbursement to a government or governmental entity for investigation costs or litigation costs incurred in such government or governmental entity's investigation into, or litigation concerning, the violation or potential violation of any law; or

(B) At the taxpayer's election, in lieu of a fine or penalty.

(5) Suit, agreement, or otherwise. A suit, agreement, or otherwise includes, but is not limited to, suits; settlement agreements; orders; non-prosecution agreements; deferred prosecution agreements; judicial proceedings; administrative adjudications; decisions issued by officials, committees, commissions, or boards of a government or governmental entity; and any legal actions or hearings which impose a liability on the taxpayer or pursuant to which the taxpayer assumes liability.

(f) Examples. The application of this section is illustrated by the following examples.

(1) Example 1.

(i) Facts. Corp. A enters into an agreement with State Y's environmental enforcement agency (Agency) for violating state environmental laws. Pursuant to the agreement, Corp. A pays \$40X to the Agency in civil penalties, \$80X in restitution for the environmental harm that the taxpayer has caused, \$50X for remediation of contaminated sites, and \$60X to conduct comprehensive upgrades to Corp. A's operations to come into compliance with the state environmental laws.

(ii) Analysis. The identification requirement is satisfied for those amounts the agreement identifies as restitution, remediation, or to come into compliance with a law. If Corp. A meets the establishment requirement, as provided in paragraph (b)(3),

paragraph (a) of this section will not disallow Corp. A's deduction for \$80X in restitution and \$50X for remediation. Under paragraph (a) of this section, Corp. A may not deduct the \$40X in civil penalties. Paragraph (a) of this section will not disallow Corp. A's deduction for the \$60X paid to come into compliance with the state environmental laws. See section 161, concerning items allowed as deductions, and section 261, concerning items for which no deduction is allowed, and the regulations related to sections 161 and 261.

(2) Example 2.

(i) Facts. Corp. A enters into an agreement with State T's securities agency (Agency) for violating a securities law by inducing B to make a \$100X investment in Corp. C stock, which B lost when the Corp. C stock became worthless. As part of the agreement, Corp. A agrees to pay \$100X to B as restitution for B's investment loss, incurred as a result of Corp. A's actions. The agreement specifically states that the \$100X payment by Corp. A to B is restitution. The agreement also requires Corp. A to pay a \$40X penalty for violating Agency law. Corp. A pays the \$140X.

(ii) Analysis. Corp. A's \$100X payment to B is identified in the agreement as restitution. If Corp. A establishes, as provided in paragraph (b)(3) of this section, that the amount paid was for that purpose, paragraph (a) of this section will not disallow Corp. A's deduction for the \$100X payment. Under paragraph (a) of this section, Corp. A may not deduct its \$40X payment to the Agency because it was paid for Corp. A's violation of Agency law.

(3) Example 3.

(i) Facts. Corp. B is under investigation by State X's environmental enforcement agency for a potential violation of State X's law governing emissions standards. Corp. B enters into an agreement with State X under which it agrees to upgrade the engines in a fleet of vehicles that Corp. B operates to come into compliance with State X's law. Although the agreement does not provide the specific amount Corp. B will incur to upgrade the engines to come into compliance with State X's law, it identifies that Corp. B must upgrade existing engines to lower certain emissions. Under the agreement, Corp. B also agrees to construct a nature center in a local park for the benefit of the community. Instead of paying \$12X, to come into compliance with State X's law, Corp. B pays \$15X to upgrade the engines to a standard higher than that which the law requires. Corp. B presents evidence to establish that it would cost \$12X to upgrade the engines to come into compliance with State X's law.

(ii) Analysis. Because the agreement describes the specific action Corp. B must take to come into compliance with State X's law, and Corp. B provides evidence, as described in paragraph (b)(3)(ii) of this section, to establish that the agreement obligates it to incur costs to come into compliance with a law, paragraph (a) of this section will not disallow Corp. B's deduction for the \$12X Corp. B incurs to come into compliance. Corp. B may also deduct the \$3X if it is otherwise deductible under chapter 1 of the Code. However, Corp. B may not deduct the amounts paid to construct the nature center because no facts exist to establish that the amount was paid either to come into compliance with a law or as restitution or remediation.

(4) Example 4.

(i) Facts. Corp. D enters into an agreement with governmental entity, Trade Agency, for engaging in unfair trade practices in violation of Trade Agency laws. The agreement requires Corp. D to pay \$80X to a Trade Agency fund, through disgorgement of net profits, to be used exclusively to pay restitution to the consumers harmed by Corp. D's violation of Trade Agency law. Corp. D pays \$80X to Trade Agency fund and Trade Agency disburses all amounts in the restitution fund to the harmed consumers.

(ii) Analysis. The agreement identifies the \$80X payment to the fund as restitution. Trade Agency uses the funds exclusively to provide restitution to the harmed consumers and does not use it for discretionary or general enforcement purposes. If Corp. D establishes, as provided in paragraph (b)(3) of this section, that the \$80X constitutes restitution under paragraph (e)(4)(i)(B) of this section, paragraph (a) of this section does not apply.

(5) Example 5.

(i) Facts. B, a regulated banking institution, is subject to the supervision of, and annual examinations by governmental entity, R. In the ordinary course of its business, B is required to pay annual assessment fees to R, which fees are used to support R in supervising and examining banking institutions to ensure a safe and sound banking system. Following an annual examination conducted in the ordinary course of B's business, R issues a letter to B identifying concerns with B's internal compliance functions. B takes corrective action to address R's concerns by investing in its internal compliance functions. R does not conduct an investigation or inquiry into B's potential violation of any law.

(ii) Analysis. The payment of annual assessment fees by B to R in the ordinary course of business is not related to the violation of any law or the investigation or inquiry into the potential violation of any law. In addition, B's costs of taking the corrective action are not related to the violation of any law or the investigation or inquiry into the potential violation of any law as described in section 162(f)(1). Paragraph (a) of this section will not disallow the deduction of the annual assessment fees and the cost of the corrective actions.

(6) Example 6.

(i) Facts. B, a regulated banking institution, is subject to the supervision of, and annual examinations by governmental entity, R. Following an annual examination conducted in the ordinary course of B's business, R pursues an enforcement action against B for violation of banking laws. B and R enter a settlement agreement, pursuant to which B agrees to undertake certain improvements to come into compliance with banking laws and to pay R \$20X for violation of banking laws. B pays the \$20X.

(ii) Analysis. If the agreement meets the identification requirement of paragraph (b)(2) of this section and B meets the establishment requirement of paragraph (b)(3) of this section, paragraph (a) of this section will not disallow the deduction of the costs of the corrective actions to come into compliance with banking laws. However, B may not deduct the \$20X paid to R because the amount was not paid to come into compliance with a law or as restitution or remediation.

(7) Example 7.

(i) Facts. Corp. C contracts with governmental entity, Q, to design and build a rail project within five years. Corp. C does not complete the project. Q sues Corp. C for

breach of contract and damages of \$10X. A jury finds Corp. C breached the contract and Corp. C pays \$10X to Q.

(ii) Analysis. The suit arose out of a proprietary contract, wherein Q enforced its rights as a private party. Paragraph (a) of this section will not disallow Corp. C's deduction of the payment of \$10X pursuant to this suit.

(8) Example 8.

(i) Facts. Corp. C contracts with governmental entity, Q, to design and build a rail project within five years. Site conditions cause construction delays and Corp. C asks Q to pay \$50X in excess of the contracted amount to complete the project. After Q pays for the work, it learns that, at the time it entered the contract with Corp. C, Corp. C knew that certain conditions at the project site would make it challenging to complete the project within five years. Q sues Corp. C for withholding critical information during contract negotiations in violation of the False Claims Act (FCA). The court enters a judgment in favor of Q pursuant to which Corp. C will pay Q \$50X in restitution and \$150X in treble damages. Corp. C pays the \$200X.

(ii) Analysis. The suit pertains to Corp. C's violation of the FCA. The order identifies the \$50X Corp. C is required to pay as restitution, as described in paragraph (b)(2) of this section. If Corp. C establishes, as provided in paragraph (b)(3) of this section, that the amount paid was for restitution, paragraph (a) of this section will not disallow Corp. C's deduction for the \$50X payment. Under paragraph (a) of this section, Corp. C may not deduct the \$150X paid for the treble damages imposed for violation of the FCA because the order did not identify all or part of the payment as restitution.

**(9) Example 9.**

(i) Facts. Corp. T operates a truck fleet company incorporated in State A. State A requires that all vehicles registered in State A have a vehicle emissions test every two years. Corp. T's 40 trucks take the emissions test on March 1 for which it pays the \$15 per vehicle. Under State A law, if a vehicle fails the emissions test, the vehicle owner has 30 days to certify to State A that the vehicle has been repaired and has passed the emissions test. State A imposes a \$1X penalty per vehicle for failure to comply with this 30-day rule. Twenty trucks pass; twenty trucks fail. Corp. T does not submit the required certification to State A for the twenty trucks that failed the emissions test. State A imposes a \$40X penalty against Corp. T. Corp. T pays the \$40X.

(ii) Analysis. Emissions tests are conducted in the ordinary course of operating a truck fleet company and, therefore, paragraph (a) of this section does not apply to the \$600 Corp. T pays for the emissions tests. However, Corp. T may not deduct the \$40X penalty for failure to comply with State A requirements because the amount is required to be paid to a government in relation to the violation of a law.

**(10) Example 10.**

(i) Facts. Corp. G operates a chain of 20 grocery stores in County X. Under County X health and food safety code and regulations, Corp. G is subject to annual inspections for which Corp. G is required to pay an inspection fee of \$40 per store. Pursuant to the annual inspection, the County X health inspector finds violations of County X's health and food safety code and regulations in three of Corp. G's 20 stores. County X bills Corp. G \$800 for the annual inspection fees for the 20 stores and a

\$1,000 fine for each of the three stores, for a total fine of \$3,000, for violations of the health and food safety code. Corp. G pays the fees and fines.

(ii) Analysis. Paragraph (a) of this section will not disallow Corp. G's deduction for the \$800 inspection fees paid in the ordinary course of a regulated business. Under paragraph (a) of this section, Corp. G may not deduct the \$3,000 fine for violation of the County X health code and food safety ordinances because it was paid to a government in relation to the violation of a law.

(11) Example 11.

(i) Facts. Corp. G operates a chain of grocery stores in County X. Under County X health and food safety code and regulations, Corp. G is subject to annual inspections. Pursuant to an annual inspection, the County X health inspector finds that the refrigeration system in one of Corp. G's stores does not keep food at the temperature required by the health and food safety code and regulations. The County X health inspector issues a warning letter instructing Corp. G to correct the violation and bring the refrigeration system into compliance with the law before a reinspection in 60 days or face the imposition of fines if it fails to comply. Corp. G pays \$10,000 to bring its refrigeration system into compliance with the law.

(ii) Analysis. Provided the identification and establishment requirements of paragraphs (b)(2) and (b)(3), respectively, of this section are met, paragraph (a) of this section will not disallow Corp. G's deduction for the \$10,000 it pays to bring its refrigeration system into compliance with the law.

(12) Example 12.

(i) Facts. Corp. G operates a chain of grocery stores in County X. Under County X health and food safety code and regulations, Corp. G is subject to annual inspections. Pursuant to an annual inspection, the County X health inspector finds that the refrigeration system in one of Corp. G's stores does not keep food at the temperature required by the health and food safety code and regulations. The County X health inspector issues a warning letter instructing Corp. G to correct the violation and bring the refrigeration system into compliance with the law before a reinspection in 60 days or face the imposition of fines if it fails to comply. The County X health inspector later reinspect the refrigeration system. Corp. G pays a reinspection fee of \$80. During the reinspection, the health inspector finds that Corp. G did not bring its refrigeration system into compliance with the law. The health inspector issues a citation imposing a \$250 fine on Corp. G. Corp. G pays the \$250 fine.

(ii) Analysis. Paragraph (a) of this section will disallow Corp. G's deduction for the \$80 inspection fee because it is paid in relation to the investigation or inquiry by County X into the potential violation of a law. Paragraph (a) of this section will also disallow Corp. G's deduction for the \$250 fine paid for violation of the law.

(13) Example 13.

(i) Facts. Accounting Firm was convicted of embezzling \$500X from Bank in violation of State X law. The court issued an order requiring Accounting Firm to pay \$100X in restitution to Bank. The court also issued an order of forfeiture and restitution for \$400X, which was seized by the State X officials. Accounting Firm paid \$100X to Bank. The \$400X seized was deposited with Fund within the State X treasury and, at

the discretion of the State X Attorney General, was used to support law enforcement programs.

(ii) Analysis. Although the order identified the amount forfeited as restitution, paragraph (a) of this section will disallow Accounting Firm's deduction for the \$400X forfeited because, under paragraph (e)(4)(i)(B)(I) of this section, it does not constitute restitution. If Accounting Firm establishes, as provided in paragraph (b)(3) of this section, that the \$100X constitutes restitution under paragraph (e)(4)(i), paragraph (a) of this section will not disallow Accounting Firm's deduction for the \$100X paid, provided the \$100X is otherwise deductible under chapter 1.

(g) Applicability date. The rules of this section apply to taxable years beginning on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, except that such rules do not apply to amounts paid or incurred under any order or agreement pursuant to a suit, agreement, or otherwise, which became binding under applicable law before such date, determined without regard to whether all appeals have been exhausted or the time for filing appeals has expired.

Par. 3. Add §1.6050X-1 to read as follows:

§1.6050X-1 Information reporting for fines, penalties, and other amounts by governments, governmental entities, and nongovernmental entities treated as governmental entities.

(a) Information reporting requirement. The appropriate official, as defined in paragraph (f)(1) of this section, of a government, as defined in paragraph (f)(2) of this section, a governmental entity, as defined in paragraph (f)(3) of this section, or nongovernmental entity treated as a governmental entity, as defined in paragraph (f)(4)

of this section, that is a party to a suit or agreement to which section 6050X(a)(1) and (a)(2) applies, must--

- (1) File an information return, as described in paragraph (b) of this section, if the aggregate amount the payor, as defined in paragraph (f)(5) of this section, is required to pay pursuant to all court orders (orders) and settlement agreements (agreements), relating to the violation of any law, or the investigation or inquiry into the potential violation of any law, equals or exceeds the threshold amount provided in paragraph (f)(6) of this section;
- (2) Furnish a written statement as described in paragraph (c) of this section to each payor; and
- (3) Request the payor's taxpayer identification number (TIN) if it is not already known, and notify the payor that the law requires the payor to furnish a TIN for inclusion on the information return and that the payor may be subject to a penalty for failure to furnish the TIN. See sections 6723, 6724(d)(3), and §301.6723-1 of this chapter. The TIN may be requested in any manner, and the payor may provide the TIN in any manner, including orally, in writing, or electronically. If the TIN is furnished in writing, no particular form is required. Form W-9, Request for Taxpayer Identification Number and Certification, may be used, or the request may be incorporated into documents related to the order or agreement.

(b) Requirement to file return--(1) Content of information return. The information return must provide the following:

(i) The amount required to be paid to, or at the direction of, a government or governmental entity, pursuant to section 6050X(a)(1)(A), as a result of the orders and/or agreements;

(ii) The separate amounts required to be paid as restitution, remediation, or to come into compliance with a law, as described in section 6050X(a)(1)(B) and (C), as a result of the orders and/or agreements;

(iii) The payor's TIN; and

(iv) Any additional information required by the information return and the related instructions.

(2) Form and manner of reporting. The appropriate official required to file an information return, under paragraph (a)(1) of this section, must file Form 1098-F, Fines, Penalties, and Other Amounts, or any successor form, as provided by the instructions, with Form 1096, Annual Summary and Transmittal of U.S. Information Returns.

(3) Multiple orders and/or agreements. The appropriate official must file only one Form 1098-F for amounts required to be paid as a result of multiple orders and/or agreements with respect to the violation, investigation, or inquiry.

(4) Time of reporting. Returns required to be made under paragraph (a) of this section must be filed with the Internal Revenue Service (IRS) on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the orders and/or agreements become binding under applicable law, determined without regard to whether all appeals have been exhausted or the time for filing an appeal has expired.

(c) Requirement to furnish written statement--(1) In general. The appropriate official must furnish a written statement to each payor for which it is required to file an information return under paragraphs (a)(1) and (b) of this section. The written statement must include:

- (i) The information that was reported to the IRS relating to such payor; and
- (ii) A legend that identifies the statement as important tax information that is being furnished to the IRS.

(2) Copy of the Form 1098-F. The appropriate official may satisfy the requirement of this paragraph (c) by furnishing a copy of the Form 1098-F, or any successor form, filed regarding the payor, or another document that contains the information required by paragraph (c)(1) of this section if the document conforms to applicable revenue procedures or other guidance relating to substitute statements. See §601.601 of this chapter.

(3) Time for furnishing written statement. The appropriate official must furnish the written statement to the payor on or before January 31 of the year following the calendar year in which the order or agreement becomes binding under applicable law, determined without regard to whether all appeals have been exhausted or the time for filing an appeal has expired.

(d) Rules for multiple payors--(1) Multiple payors -- individual liability. If, pursuant to an order or agreement, multiple individually liable payors are liable to pay, for the violation of any law, or the investigation or inquiry into the potential violation of any law, an amount that, in the aggregate, equals, or exceeds, the threshold amount under paragraph (f)(6) of this section, the appropriate official must file an information return

under paragraphs (a)(1) and (b) of this section to report the amount required to be paid by each payor, even if a payor's payment liability is less than the threshold amount. The appropriate official must furnish a written statement, under paragraph (c) of this section, to each payor. If more than one person, as defined in section 7701(a)(1), is a party to an order or agreement, there is no information reporting requirement, or requirement to furnish a written statement, with respect to any person who does not have a payment obligation or obligation for costs to provide services or to provide property.

(2) Multiple payors -- joint and several liability. If, pursuant to an order or agreement, multiple payors are jointly and severally liable to pay, for the violation of any law, or the investigation or inquiry into the potential violation of any law, an amount that, in the aggregate, equals or exceeds the threshold amount under paragraph (f)(6) of this section, the appropriate official must file an information return, under paragraphs (a)(1) and (b) of this section for each of the jointly and severally liable payors. Each information return must report all amounts required to be paid by all of the payors pursuant to the order or agreement. The appropriate official must furnish a written statement, under paragraph (c) of this section, to each of the jointly and severally liable payors.

(e) Payment amount not identified. If some or all of the payment amount is not identified, as described in §1.162-21(b)(2)(iii), for paragraphs (a), (b), and (c) of this section, the appropriate official must file an information return, and furnish the written statement to the payor, as provided by the instructions to Form 1098-F, or any successor form, including instructions as to the amounts (if any) to include on Form

1098-F, only if the government or governmental entity reasonably expects that the aggregate amount required to be paid or incurred pursuant to the order or agreement, relating to the violation of any law, or the investigation or inquiry into the potential violation of any law, will equal or exceed the threshold amount under paragraph (f)(6) of this section.

(f) Definitions. The following definitions apply under this section:

(1) Appropriate official--(i) One government or governmental entity. If the government or governmental entity has not assigned one of its officers or employees to comply with the reporting requirements of paragraph (a), (b), and (c) of this section, the term appropriate official means the officer or employee of a government or governmental entity having control of the suit, investigation, or inquiry. If the government or governmental entity has assigned one of its officers or employees to comply with the reporting requirements of paragraph (a), (b), and (c) of this section, such officer or employee is the appropriate official.

(ii) More than one government or governmental entity--(A) In general. If more than one government or governmental entity is a party to an order or agreement, only the appropriate official of the government or governmental entity listed first on the most recently executed order or agreement is responsible for complying with all reporting requirements under paragraphs (a), (b), and (c) of this section, unless another appropriate official is appointed by agreement under paragraph (f)(1)(ii)(B) of this section.

(B) By agreement. The governments or governmental entities that are parties to an order or agreement may agree to appoint one or more other appropriate officials to

be responsible for complying with the information reporting requirements of paragraphs (a), (b), and (c) of this section.

(2) Government. For purposes of this section, government means the government of the United States, a State, the District of Columbia, or a political subdivision (such as a local government unit) of any of the foregoing.

(3) Governmental entity. For purposes of this section, governmental entity means--

- (i) A corporation or other entity serving as an agency or instrumentality of a government (as defined in paragraph (f)(2) of this section), or
- (ii) A nongovernmental entity treated as a governmental entity as described in paragraph (f)(4) of this section.

(4) Nongovernmental entity treated as governmental entity. For purposes of this section, the definition of nongovernmental entity treated as a governmental entity as set forth in §1.162-21(e)(3) applies but does not include a nongovernmental entity of a territory of the United States, including American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands, a foreign country, or an Indian tribe.

(5) Payor. The payor is the person, as defined in section 7701(a)(1), which, pursuant to an order or agreement, has paid or incurred, or is liable to pay or incur, an amount to, or at the direction of, a government or governmental entity in relation to the violation or potential violation of any law. In general, the payor will be the person to which section 162(f) and §1.162-21 of the regulations apply.

(6) Threshold amount. The threshold amount is \$50,000.

(g) Applicability date. The rules of this section apply only to orders and agreements, pursuant to suits and agreements, which become binding under applicable law on or after January 1, 2022, determined without regard to whether all appeals have been exhausted or the time for filing an appeal has expired.

**Sunita Lough,**

*Deputy Commissioner for Services and Enforcement.*

Approved: January 7, 2021

**David J. Kautter,**

*Assistant Secretary of the Treasury (Tax Policy).*