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**From:** [REDACTED]  
**Sent:** Wednesday, March 24, 2021 12:48:36 PM  
**To:** [REDACTED]  
**Cc:** [REDACTED]  
**Bcc:**  
**Subject:** Section 162(f) – FCA Settlements and FMIS Reports

Good afternoon. This email responds to your request for expedited informal advice concerning the application of the pre-TCJA version of IRC § 162(f) to False Claims Act (“FCA”) cases for which the settlement agreement does not address the federal tax treatment of the settlement amount. Specifically, you asked for our opinion about the significance of the Financial Management Information Systems Report (“FMIS Report”) prepared by the Department of Justice (“DOJ”).

Deductions from income are a matter of legislative grace and the burden of clearly showing the right to the claimed deduction is on the taxpayer. INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84 (1992); Deputy v. du Pont, 308 U.S. 488, 493 (1940). IRC § 162(a) permits a deduction for ordinary and necessary trade or business expenses incurred during a taxable year. IRC § 162(f), however, denies a deduction otherwise allowable under IRC § 162(a) if the expense is for a fine or similar penalty paid to a government for the violation of any law. Treas. Reg. § 1.162-21(b)(1)(ii) and (iii) define a fine or similar penalty for purposes of IRC § 162(f) as including an amount paid as a civil penalty imposed by federal, state, or local law and an amount paid in settlement of the taxpayer’s actual or potential liability for a fine or penalty (civil or criminal). However, compensatory damages paid to a government do not constitute a fine or penalty. Treas. Reg. § 1.162-21(b)(2).

Under the FCA, 31 U.S.C. §§ 3729 - 3733, the government or a party suing on its behalf, may recover for false claims made by the defendant to secure a payment by the government. See generally Universal Health Servs., Inc. v. United States ex rel. Escobar, 136 S. Ct. 1989 (2016). A violator of the FCA can be subject to a civil penalty of up to \$10,000 per false claim, plus three times the amount of damages that the government sustains. 31 U.S.C. § 3729(a)(1).

The FCA was enacted in 1863 to combat rampant fraud related to Civil War defense contracts. Universal Health Servs., Inc., 136 S. Ct. at 1996 (citing United States v. Bornstein, 423 U.S. 303, 309 (1976); United States v. McNinch, 356 U.S. 595, 599 (1958)). As originally enacted, the FCA imposed civil and criminal liability on violators, subjecting them “to double damages, forfeiture, and up to five years’ imprisonment.” Id. (citing Act of Mar. 2, 1863, ch. 67, 12 Stat. 696).

Since then, Congress has amended the FCA. Prior to its amendment in 1986, the FCA imposed double damages and a civil penalty of \$2,000 per claim. See Vermont Agency of Natural Resources v. United States ex rel. Stevens, 529 U.S. 765, 785 (2000) (hereinafter Stevens). The 1986 amendments to the FCA increased the civil liabilities to treble damages and a civil penalty of up to \$10,000 per claim; these liabilities remain the same under the current version of the FCA. 31 U.S.C. § 3729(a)(1). In Bornstein, the Supreme Court determined that the pre-1986 FCA's double damages provision could serve compensatory purposes. 423 U.S. at 315 (1976); see also Talley Indus. Inc. v. Commissioner, 116 F.3d 382, 387 (9th Cir. 1997). In considering the 1986 amendment to the FCA instituting treble damages, however, the Supreme Court held that "Congress also has increased the Act's civil penalties so that liability is 'essentially punitive in nature.'" United Health Servs., Inc., 136 S. Ct. at 1996 (quoting Stevens, 529 U.S. at 784); see also Stevens, 529 U.S. at 784-86 (distinguishing Bornstein as applying to an earlier version of the FCA which imposed double damages rather than treble damages). In Stevens, the Supreme Court noted that "[t]he very idea of treble damages reveals an intent to punish past, and to deter future, unlawful conduct, not to ameliorate the liability of wrongdoers." 529 U.S. at 786 (quoting Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 639 (1981)).

Single damages, as opposed to double or treble damages, are compensatory and therefore deductible. Treas. Reg. § 1.162-21(c), Example 1. Double damages, before and after the 1986 amendments to the FCA, have both compensatory and punitive purposes; depending on the facts, a portion of double damages could be deductible under § 162. See Bornstein, 423 U.S. at 315. The treble damages portion of liability under the current version of the FCA is punitive in nature and is therefore not deductible. See United Health Servs., 136 S. Ct. at 1996; Stevens, 529 U.S. at 784-86; Treas. Reg. § 1.162-21(b)(2).

"Because tax deductions 'are matters of legislative grace[,] the taxpayer bears the burden of proving entitlement to any deduction.'" Fresenius Medical Care Holdings, Inc. v. United States, 763 F.3d 64, 68 (1st Cir. 2014) (quoting MedChem (P.R.), Inc. v. Commissioner, 295 F.3d 118,123 (1st Cir. 2002) (citing INDOPCO, Inc., 503 U.S. at 84)) (alteration in original). Section 162(f) prohibits a deduction for any fine or similar penalty paid to the government for the violation of any law. Nondeductible fines include civil penalties and amounts paid in settlement of potential liability for a nondeductible fine or penalty, but not compensatory damages. Fresenius, 763 F.3d at 68 (citing Treas. Reg. § 1.162-21(b)). "If evidence to establish a deduction is lacking, the taxpayer, not the government, suffers the consequence." Talley Indus. Inc., 116 F.3d at 387-88 (reversing the Tax Court's holding that because the government never suggested it was attempting to extract a penalty, the amount was therefore compensatory); Talley Indus., Inc. v. Commissioner, T.C. Memo. 1999-200 (stating that the taxpayer "bears the burden of proving that, in settling the . . . matter, the parties intended for the entire \$2.5 million payment (including the \$940,000 portion of the payment that exceeded the Government's \$1.56 million 'singles' damages) to represent compensation to the Government for its losses"), aff'd, 18 Fed. App'x 661 (9th Cir. 2001).

Under the Miscellaneous Receipts Act (“MRA”), 31 U.S.C. § 3302(b), an official or agent of the Government receiving money for the Government from any source shall generally deposit the money in the Treasury as soon as practicable without deduction for any charge or claim. See, e.g., United States v. Smithfield Foods, Inc., 982 F. Supp. 373, 375-76 (E.D. Va. 1997). While the MRA applies to money received “from any source,” the Comptroller General and the Executive Branch have recognized two exceptions to this general rule. The first exception applies when Congress has specifically authorized the agency to retain recovered funds. (Strictly speaking, that circumstance is not an exception, but rather an example of a specific statute modifying a general one.) The second exception addresses refunds to appropriations and permits an agency to retain a recovery of an amount it erroneously paid from an appropriation or fund account. For authoritative opinions of the Comptroller General, see *In re Tenn. Valley Auth. False Claims Act Recoveries*, B-281064, 2000 CPD ¶ 41, (Comp. Gen. Feb. 14, 2000), 2000 WL 230221; *In re Fed. Emergency Mgmt. Agency—Disposition of Monetary Award Under False Claims Act*, 69 Comp. Gen. 260 (1990). For authoritative opinions from DOJ, see *Application of the Miscellaneous Receipts Act to the Settlement of False Claims Act Suits Concerning Contracts with the Gen. Servs. Admin.*, 30 Op. O.L.C. 53 (Jan. 10, 2006), 2006 WL 8448036; *Apportionment of False Claims Act Recoveries to Agencies*, 28 Op. O.L.C. 25 (Mar. 12, 2004), 2004 WL 5277346.

The application of the MRA in the FCA context has been described as follows:

While most litigation awards must therefore be deposited into the Treasury, the refund exception does permit an agency to retain the portion of a judgment corresponding to an erroneous payment. Thus, in a False Claims Act suit, an agency may retain compensatory damages awards that reflect the payments the agency was fraudulently induced to make. *See FCA Suits*, 30 Op. O.L.C. at 59; *Apportionment of False Claims Act Recoveries to Agencies*, 28 Op. O.L.C. 25, 27 (2004) (“*FCA Recoveries*”); *Federal Emergency Management Agency—Disposition of Monetary Award Under False Claims Act*, 69 Comp. Gen. 260, 262 (1990) (“*FEMA*”); *Tennessee Valley Authority—False Claims Act Recoveries*, B-281064, 2000 WL 230221, at \*2 (Comp. Gen. Feb. 14, 2000) (“*TVA*”). By contrast, if the agency recovers treble damages in a False Claims Act suit, the agency must deposit in the Treasury the portion of the award that goes beyond the actual losses incurred. *TVA*, 2000 WL 230221, at \*3.

*Applicability of the Miscellaneous Receipts Act to an Arbitral Award of Legal Costs*, 2018 WL 3450204, at \*4 (O.L.C. Mar. 6, 2018).

With respect to relator fees, the FCA specifically authorizes the payment of those amounts to relators. 31 U.S.C. § 3730(d). Payments into the Working Capital Fund (3% - DOJ Investigative Costs) are also specifically authorized by statute. 21st Century Department of Justice Appropriations Authorization Act, Pub. L. No. 107-273, div. C., tit. I, § 11013(a), 116 Stat. 1758, 1823 (2002) (28 U.S.C. § 527 note). Payments for relator fees and DOJ investigative costs are not precluded from being deducted by IRC § 162(f).

It is important to obtain the FMIS Report from DOJ when determining how much of the settlement is compensatory and how much is punitive. The FMIS Report reflects DOJ's receipt of the total settlement amount and the disbursement of the total to all sources. The FMIS Report provides evidence of the allocation of the settlement proceeds between compensatory and punitive amounts because it shows how DOJ categorized each component of the total settlement when complying with the requirements of the MRA. As explained above, the amount deposited into the Treasury is punitive and non-deductible under IRC § 162(f).

Pursuant to established procedures, a copy of this email will be released to the public as Emailed Chief Counsel Advice (with our names redacted). This advice may not be used or cited as precedent. Please call me if you have any further questions.