RILA
RETAIL INDUSTRY LEADERS ASSOCIATION
1700 North Moore Street, Suite 2250, Arlington, VA 22209

May 18, 2018

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2018-23)
Room 5203
P.O. Box 7602
Ben Franklin Station
Washington, D.C. 20444

Re: Notice 2018-23 - Transitional Guidance Under Sections 162(f) and 6050X with Respect to Certain Fines, Penalties, and Other Amounts

Dear Sir/Madam:

The Retail Industry Leaders Association ("RILA") thanks you for the opportunity to provide comments on Notice 2018-23 to the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") concerning proposed regulations with respect to Sections 162(f) and 6050X of the Internal Revenue Code of 1986, as amended (the "Code").

The Tax Cuts and Jobs Act, enacted late last year, made significant changes to the Code in many areas. This includes changes to the tax deductibility of certain fines, penalties, and other amounts paid to the government or to a governmental entity due to a violation or potential violation of the law. As the Treasury and the IRS work to update guidance in this area, RILA appreciates your consideration of our views highlighted below.

RILA and Its Members

RILA is the trade association of the world's largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs, and more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad. More than 42 million jobs in the United States are either a retail job or a job that relies on retail. Because of the retail industry's role as a significant employer, and the billions of dollars retailers pay in federal, state and local taxes, few industries have a greater impact on the U.S. economy than retail. The proper tax treatment for payments made as settlement of fines, penalties and other amounts paid to the government due to a potential violation of the law is a significant issue for RILA's members.

Postpone implementation of Identification Requirement until Reporting Requirement is fully implemented

Under current law, taxpayers may not deduct amounts paid to or at the direction of a government or governmental entity due to a violation or potential violation of the law, unless certain requirements, outlined in section 162(f), are met. More specifically, in order to sustain a

deduction (1) the taxpayer must establish that the amount paid constitutes restitution, remediation or payments to come into compliance with the law (the "Establishment Requirement") and (2) the amount paid must be identified in the settlement agreement or court order as restitution, remediation or payments to come into compliance with the law (the "Identification Requirement"). The Identification Requirement can only be met if a court or settlement agreement identifies the amount paid as restitution, remediation or in order to comply with the law. Therefore, it is necessary for the government or governmental entity to agree to a characterization of the nature of the payment.

Section 6050X contains a requirement for governments and government agencies to report (to the IRS and to the defendant) the amount of any settlement payments that constitute restitution, remediation or payments to come into compliance with the law as described in amended section 162(f) (the "Reporting Requirement"). Under Notice 2018-23, the Reporting Requirement is postponed until at least January 1, 2019. However, taxpayers will still have to comply with the Identification Requirement. This is problematic because the Department of Justice ("DOJ") generally does not include language in its settlement agreements that explain the characterization, and instead uses the following standard language:

> *Nothing in this paragraph or any other provision of this Agreement constitutes an agreement by the United States concerning the characterization of the Settlement Amount for purposes of the Internal Revenue laws, Title 26 of the United States Code.*

RILA is concerned that the current language used by DOJ makes it impossible for any taxpayer to satisfy the Identification Requirement. In addition to developing the systems necessary to meet the Reporting Requirement, DOJ will likely need to modify its settlement policies and educate their attorneys about the new law and requirements. We propose that the enforcement of the Identification Requirement be delayed until the Reporting Requirements are fully implemented.

If the Identification Requirement is not delayed, the characterization, and therefore the deductibility, of a settlement payment could depend on which attorney within a governmental agency was assigned a particular case and whether that attorney is aware of the Identification Requirement and use such awareness to inform the negotiation of the settlement agreement. If the attorney is not aware of the Identification Requirement, then the attorney may insist upon the boilerplate language quoted above, and the taxpayer would be unable to satisfy the Identification Requirement. As a result, failure to postpone implementation of the Identification Requirement could arbitrarily lead to different results for similarly situated taxpayers.

Definition of Restitution Should Include Awards Measured by Enrichment of the Defendant

Although deductibility under Section 162(f) hinges on whether a payment is for "restitution," Section 162(f) neither contains, nor references a definition of the term restitution. Depending on the context, "restitution" has very different definitions, so it is important that the regulations under Section 162(f) define restitution. Historically, restitution has been understood as a remedy based on the unjust enrichment of one party and does not focus on the loss to the other party. For

example, if a False Claims Act ("FCA") complaint was filed against a company, the government's claim for restitution could be based on the amount the company gained from the alleged violation.

RILA believes it is a sound approach to define restitution to include, among other things, awards measured by the enrichment of the defendant. First, such a definition would provide symmetry between the deductible portion of the settlement payment and the income on which the defendant has already paid income tax. For instance, when a company earns income related to claims that are allegedly violations of the FCA, it pays tax on that income. If the company is required to repay those gains as part of the settlement in the form of restitution, it is reasonable that the company should be able to deduct that amount from income. Otherwise, the company would essentially be paying tax on an amount it did not retain.

Second, defining restitution based on the gains of the defendant (as opposed to the losses of the plaintiff) is more consistent with the Establishment Requirement in that a defendant can independently establish the amount that it was enriched as a result of any alleged law violations. By contrast, a defendant would not necessarily be able to independently establish the amount that the governmental entity (or other payee) was harmed as a result of an alleged law violation as the governmental entity would control such information.

However, in some cases the harm done to the governmental entity may exceed the unjust enrichment of the defendant. In such cases, if the settlement were based on that higher amount, we believe the company should be able to fully deduct that amount. Therefore, RILA thinks that the definition of restitution for purposes of Section 162(f) should be as follows:

> *the greater of:*
> *(a) the amount by which the defendant was enriched as a result of the alleged violation; or*
> *(b) the amount by which the governmental entity (or other payee) was harmed as a result of the alleged violation.*

RILA does not believe the definition of restitution should be based *solely* on harm done to the governmental entity (or other payee). Such a definition would require complete reliance on the governmental entity to satisfy the Establishment Requirement and could completely eliminate a deduction for single damages in certain cases.

Establishment Requirement should be satisfied by the calculation of single damages sustained

In order to satisfy the Establishment Requirement, the taxpayer must establish that an amount paid pursuant to a settlement agreement or a court order "constitutes 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, or is paid to come into compliance with any law which was violated or otherwise involved in the investigation or inquiry." Section 162(f) clearly states that although a court order or settlement agreement that identifies a particular amount as

restitution may be sufficient to satisfy the Identification Requirement, it is insufficient to satisfy the Establishment Requirement. Section 162(f) is silent, however, on the documents or other evidence that can be used to satisfy the Establishment Requirement.

In cases in which the governmental entity seeks damages based on its losses (as opposed to the enrichment of the defendant), the governmental entity controls the information that would establish that a settlement amount constituted restitution. Such information generally is shared with the defendant as part of the settlement negotiations or in a plea for damages. Often, the amount advanced as single damages by the governmental entity is greater than the settlement amount. In such cases, it may be difficult (or impossible) for the defendant to recreate those calculations or independently validate such amounts.

In light of this issue, RILA proposes that a governmental entity's calculation of single damages sustained as a result of an alleged violation of a law should per se satisfy the Establishment Requirement up to that amount, whether contained in a document filed with the court or otherwise communicated to the defendant as part of the settlement negotiations. In other words, if the governmental entity made a plea for single damages in the amount of $100 and the parties ultimately agreed to a settlement amount of $50, that entire $50 should be deductible because it is less than the amount claimed as single damages by the governmental entity and that claim for damages establishes the maximum restitution amount. If taxpayers could not rely on such damage claims or calculations, the implication could be drawn that governmental entities are making bloated or frivolous damage claims in such proceedings.

Identification Requirement is clear and does not need additional clarification

The Notice states that until regulations under Section 162(f) are issued, the Identification Requirement will be considered satisfied if the settlement agreement or court order specifically states that the amount is restitution, remediation or for coming into compliance with the law. However, Section 162(f) already clearly and unambiguously provides that the Identification Requirement is satisfied if the settlement agreement or court order specifically states that the amount is restitution, remediation or for coming into compliance with the law. We believe that there is no need for additional clarification of the Identification Requirement and Treasury should not issue any regulations that seek to further define or explain the Identification Requirement. Any additional guidance in the form of regulations likely would confuse what is already a fairly clear requirement in Section 162(f).

Relator Fees Should Be Tax Deductible

Many FCA cases are brought as qui tam lawsuits by individuals (relators) on behalf of the government. Upon a favorable settlement, relators receive a share of the settlement award as well as attorneys' fees. Section 162(f) as amended does not address the deductibility of amounts paid to relators or their attorneys, but we believe that such amounts should be fully deductible by the payor. Unlike amounts paid to the government, the amounts paid to the relators and to their attorneys generally are taxable as ordinary income. Because such amounts are taxable to the recipient, it stands to reason that they should also be tax deductible by the payor.

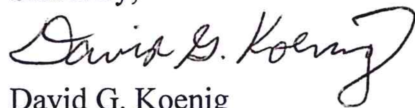
If such amounts are not fully tax deductible, then the payor should be permitted to deduct a portion of the relator fee and the relator's attorney's fees that bears the same ratio as the deductible payment to the governmental entity bears to the total settlement amount. For example, if the sum of the relator fee and the relator's attorney's fees is $200, the total payment to the governmental entity is $1000, and the amount that is established and identified as deductible restitution is $500, then 500/1000, or 50 percent of the $200 paid to the relators and their attorneys should be deductible. Therefore, the payor would be entitled to deduct $100 of the $200 paid to the relator and their attorneys.

RILA also urges the IRS to avoid regulations that would treat relator fees and relators' attorneys' fees in the following ways. First, if relator fees and relator's attorney's fees are considered to be amounts paid at the direction of the government, then the settling defendant would need to separately meet the Identification and Establishment Requirements with respect to those payments. This causes a problem, since the relator in such cases generally has not suffered any damages directly from the alleged violation of the law, and therefore it may be impossible to establish that amounts paid to relators or their attorneys constitute restitution. Second, the relator fee and the relator's attorney's fees should not be treated as litigation or investment cost of the government. Under Section 162(f), as amended, such costs explicitly do not constitute restitution and, as such, would not be deductible.

Conclusion

RILA appreciates the opportunity to provide comments on Notice 2018-23. We hope you will consider our recommendations as you work to update regulations and guidance under Code Sections 162(f) and 6050(X). If you would like to discuss our recommendations in this letter, please contact David G. Koenig at 703-600-2051 or at david.koenig@rila.org.

Sincerely,



David G. Koenig
Vice President, Tax
Retail Industry Leaders Association