DEDUCTIBILITY AND INFORMATION REPORTING OF RESTITUTION PAYMENTS: TRANSITIONAL GUIDANCE ISSUED

The Tax Cuts & Jobs Act made significant changes to Section 162(f) with respect to the deductibility of certain fines, penalties, and other amounts, including restitution payments. Previously, Section 162(f) barred a deduction for fines or penalties paid to a government for the violation of any law. There was much debate over whether restitution payments for unpaid taxes were compensatory/remedial in nature/constituted reimbursement to government and therefore deductible versus punitive and therefore non-deductible.

As it pertains to tax restitution, new Section 162(f) now has an explicit carve-out for restitution payments made (or amounts paid to come into compliance with the law) provided that such restitution amounts (or amounts paid to come into compliance with the law) are identified as restitution or as an amount paid to come into compliance in the court order or settlement agreement.

The new statute provides that restitution amounts do not include amounts paid or incurred as reimbursement to government for costs of any investigation or litigation. The new law also explicitly states that the prohibition on a deduction for a fine or fee paid to the government does not apply to any amount paid or incurred as taxes due. The statute does not define “taxes due” or indicate whether it includes penalties and additions to state and federal taxes. At bottom, the statute ushers in significant changes with respect to the deductibility of restitution payments.

The other big change initiated by the statute is that it imposes information reporting obligations on the government regarding restitution amounts agreed upon, to be filed with the IRS at time any agreement is entered into. New Section 162(f) added a new section to the Code, Section 6050X, to implement and enforce the new information reporting.

Although regulations have not yet been proposed or issued, on March 27, the IRS issued transitional guidance under new Sections 162 and 6050X in Notice 2018-23. As an initial matter, the Notice makes clear that no information reporting under Section 6050X will be required until whatever date is specified in the proposed regulations, which in any event will not be before January 1, 2019. Thus, any agreements entered into before the specified date do not have the reporting requirement.

However, Section 162(f) has already taken effect so, to ensure a restitution payment is deductible, any taxpayer desiring to take a deduction for a restitution payment must meet the terms of the statute establishing