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MEMORANDUM

TO: All Agency Accounting and Legal Contacts

FROM: Kathleen D. Baxter
State Comptroller 

DATE: April 21, 2022

SUBJECT: Fines and Penalties Paid to State Due to Violations of Law

Background

A newly effective federal law¹ requires Alabama to file an informational tax return with the Internal Revenue Service to report amounts exceeding \$50,000 required to be paid by a taxpayer related to the violation of any law. All agencies will need to submit information to the Comptroller's Office so that Alabama can comply with the new reporting requirements.

The US Internal Revenue Code section 162(f)(1) states that no tax deduction is allowed for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

This section generally applies to liabilities arising out of violations of criminal or civil laws, including federal, state, local, and foreign laws. This rule does not prevent deductions for payments made in response to "routine investigations or inquiries, such as audits and inspections, of regulated businesses that are not related to any evidence of wrongdoing or suspected wrongdoing."² Section 162(f)(1) also does not apply to an order or agreement from a lawsuit in which the state enforces its rights as a private party contracting for goods or services.

Section 162(f)(2) provides that amounts paid for restitution, remediation of property, or to come into compliance with any law are not disallowed as a deduction if (a) the taxpayer establishes that the payment was made for such a purpose and (b) the payment is identified as restitution or to

¹ The 2017 Tax Act (P.L. 115-97, also referred to as the Tax Cuts and Jobs Act of 2017 or TCJA) significantly modified US Internal Revenue Code (IRC) section 162(f) and added section 6050X.

² 26 CFR § 1.162-21.

come into compliance with the law in the court order or settlement agreement. The accompanying regulations at 26 CFR § 1.162-21(2) expound the on establishment and identification requirements.

Section 6050X requires the governmental official involved in a suit or agreement related to the violation of any law, or investigation of a potential violation of law, to file an informational return that includes:

1. The amount required to be paid to which section 162(f)(1) applies;
2. Separate amounts required to be paid as restitution, remediation of property, or to come into compliance a law as a result of a court order or settlement agreement;
3. The payer's TIN; and
4. Any additional information required by the information return and related instructions (Form 1098-F, Fines, Penalties, and Other Amounts).

The informational return is only required if the aggregate amount required to be paid by the payer relating to a violation or potential violation of law is \$50,000 or greater. If the payment amount is not identified, an informational return must be filed if the aggregate amount required to be paid is reasonably expected to exceed \$50,000.

What Agencies are Asked to Provide

1. A copy of the document(s) that requires payment by the taxpayer related to the violation of law, e.g., judge's order, settlement agreement, deferred prosecution agreement, administrative adjudications.
2. A copy of the taxpayer's W-9.
3. A completed IRS Form 1098-F, found at <https://www.irs.gov/pub/irs-pdf/f1098f.pdf>. Do not submit this form to the IRS. The Comptroller's Office will file all forms on behalf of the State.
4. All of the above should be provided immediately after the order or agreement is finalized. Any cases finalized late in the year must be provided by January 15th of the following year in order to meet IRS filing deadlines.

Please provide this information to the Comptroller by emailing Chris Lovett at chris.lovett@comptroller.alabama.gov. If you need assistance or have additional questions, please contact Chris at (334) 353-2565.

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