I'll Pay, but Let's Not Call It a Fine: Code Sec. 162(f) Issues in Structuring Settlement Payments–Five Lessons from LTR 200502041

By Brian R. Lynn

Brian R. Lynn details a roadmap for the tax issues that surface with settlement payments and emphasizes the Code Sec. 162(f) fine-or-penalty issue.

I. Introduction

On April 25, 2005, Adelphia Communications Corp., along with executives John and Timothy Rigas, agreed to pay about $2.2 billion in cash and other assets to the government to settle claims stemming from the government's ongoing accounting fraud investigation.[1] The Rigases also hope that these payments will lighten their pending prison sentences (they were convicted of fraud and conspiracy last year). But what are the tax consequences of these payments? Can Adelphia and the Rigases deduct these payments as business expenses and potentially claim huge tax refunds as a result? Or are these payments simply nondeductible fines? This situation generates a lot of tax questions—but the main issue is Code Sec. 162(f), which prohibits taxpayers from deducting fines or penalties.

Under Code Sec. 162(f),[2] taxpayers cannot deduct fines or similar penalties. This rule seems simple enough: If you get a parking ticket—even while making a business delivery—you can't deduct it. But the application of Code Sec. 162(f) is not as easy with complex settlement payments (like Adelphia and the Rigases), where a taxpayer pays a lump sum to settle many claims (some penal, some not). This uncertainty creates planning opportunities for tax advisors to massage the settlement process to produce the best after-tax outcome for the client. This article provides a roadmap for the tax issues that surface in the settlement payment context—and emphasizes the Code Sec. 162(f) fine-or-penalty issue.

The balance of this article is divided into five parts. Section II covers some typical settlement payment fact patterns. Section III reviews the settlement payment tax basics (*i.e.*, what you need to worry about before getting to Code Sec. 162(f)). Section IV outlines Code Sec. 162(f) and covers three major issues that arise in determining whether a payment is a fine or penalty. Section V summarizes recently issued LTR 200502041, then gives five tips (from the ruling) to use when advising clients making settlement payments. Section VI is a conclusion.

II. When Do Code Sec. 162(f) Issues Arise?

Code Sec. 162(f) issues usually surface when a client did something dumb. We have all had clients do dumb things. They "borrowed" a little of their employer's money without telling. They overbilled the government. They fudged a couple of numbers to make the third-quarter results look better. They neglected to mention their MasterCard with the Cayman Bank. (Insert your own story here.)

And if they became a client, that means they got caught. Their first call—if they're smart—is to their defense lawyer. The defense lawyer has two main jobs: (1) to keep

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the client out of jail (or at least get them into a country club/Martha Stewart–type jail), and (2) to limit the size of the client's restitution and penalty payments. This work involves substantial negotiations (and expensive conference calls) with those that are investigating or already suing the client—*e.g.*, government agencies, defrauded customers, class-action plaintiffs. On the government side, the investigation can be civil, criminal or both. Nongovernment plaintiffs sue the client to recover their losses, and often ask for punitive damages as well.

Occasionally, these lawsuits are tried to a verdict and a judge tells the client what to pay under each claim. But more often they settle—either separately or in some type of consolidated settlement agreement. And when they settle, the client's advisor must carefully consider the tax consequences of the different payment structures. To do this well, the advisor must understand two things. First, the advisor must grasp the generic tax issues involved with settlements: Is the payment deductible? Where/how? Must it be capitalized? Is it a nondeductible penalty or bribe? What about the alternative minimum tax (AMT)? Second, the advisor should know the client's particular tax and financial picture (*e.g.*, does the client have substantial future income, expiring NOLs, excess capital losses?), because making a deductible $10 million payment will usually trump a nondeductible $8 million payment, but not for every client.

This article doesn't tackle all of these questions. Instead, it briefly reviews the three main deduction avenues for taxpayers making settlement payments (Code Sec. 162, Code Sec. 165 and Code Sec. 212). Then it covers the more complicated Code Sec. 162(f) issue—whether a payment is a nondeductible fine or penalty—in some detail.

III. Settlement Payment Tax Basics–Before You Get to Code Sec. 162(f)

General Framework: Origin of the Claim

When lawsuits get tried and a decision is issued, it's easy to characterize the payments. The judge says how much the defendant must pay under each cause of action (*e.g.*, a $100 fine to the government, and $200 to the defrauded customers)—and this judgment governs the tax outcome. But when cases settle, the tax picture becomes jumbled because no one tells the taxpayer how to allocate the payments.

To address this problem, the courts developed the origin-of-the-claim doctrine, which tells taxpayers to look at the underlying legal claims to unpack the tax consequences of a payment received (or made) in the settlement context.[3] In other words, taxpayers are supposed to guess at what the likely outcome of each claim would have been, and characterize the payments accordingly. This rule isn't perfect, but it's the only theoretically correct option—given that no one really knows exactly how the payments should be allocated.

Taxpayers need this origin-of-the-claim rule when they make one payment to settle multiple investigations or lawsuits (*i.e.*, global settlements). In such instances, taxpayers must weigh the relative merits of the asserted claims. For example, assume that one day you are going through your law office bills and you discover that your paper supplier has been double-charging you. One Saturday at the supermarket, you confront her. In response, she drops a watermelon on your foot and breaks your toe. You sue her for both the double billing and your broken toe. The case settles jointly for $1,000. The paper supplier must decide how to treat this $1,000 payment on her tax return. The supplier can deduct her restitution for double billing as a business expense, but cannot deduct the payment for dropping the watermelon on your toe. Under the origin-of-the-claim rule, the paper supplier must determine the relative merits of these two claims, and choose what portion of the $1,000 she should allocate to each claim.

Business vs. Personal Expenses

This origin-of-the-claim rule just tells taxpayers how to categorize settlement payments made or received. Step two is to decipher the tax consequences of each category. This often involves lots of layers and nuance, but the first broad-brush question (for individual payers[4]) is whether the payment is a deductible business expense[5] or a nondeductible personal payment.[6]

Consider an example involving the white-collar defense lawyer's favorite client, Bad CEO. Bad CEO is sued because he did two bad things: (1) he told his employees to dump toxic waste in the river, and (2) he sexually harassed the office manager. The former is probably business related and deductible, and the latter is likely not.[7] In determining how much of this $20 million payment he can deduct, Bad CEO must weigh the merits of each claim. If 40 percent of his potential liability related to the sexual harassment, Bad CEO should not deduct 40 percent ($8 million)

of the payment, because it's a personal expense. The comparative strength of each claim—and the potential damages associated therewith—govern how the payment is allocated and taxed.

For business-related payments, the next question is if the payments are "ordinary and necessary" business expenses under Code Sec. 162(a). This fundamental tax issue is beyond the scope of this article, but one interesting "ordinary and necessary" issue in the settlement payment context is whether taxpayers can deduct payments made for dumb/bad things done while running a business. In other words, if you steal money in the context of your job, then get caught and have to pay it back, can you deduct the repayment? Is stealing or cheating an "ordinary" part of a trade or business? Certainly not. Not in America! But the general answer is yes, taxpayers can deduct the repayment of stolen or ill-gotten money as a business expense.[8]

How can this be? Well, Congress really had three alternatives here. First, it could have picked the Machiavellian approach, and said that taxpayers can deduct all business-related payments—no matter what the payment is for, or how nefarious the conduct. Conversely, Congress could have decided that any payment related to "bad" behavior is nondeductible, because we don't want to give tax breaks to liars and thieves. Congress chose neither. It compromised by enacting Code Sec. 162(f)—which lets taxpayers deduct restitutionary repayments, but not punitive payments. In other words, if an employee steals $200 from his company, and has to pay the $200 back plus a $50 fine to the government, the employee can deduct the $200 repayment but not the $50 fine.

> This rule seems simple enough: If you get a parking ticket—even while making a business delivery—you can't deduct it.

In-Between Expenses: Code Sec. 212 and Code Sec. 165

The tax world isn't just divided into business and personal expenses, however—at least for individual taxpayers. There are other payment categories to choose from. And they generally apply to "in-between" payments, which aren't business expenses, but are pretty close.

The first is Code Sec. 212, *Expenses for Production of Income,* through which taxpayers can deduct profit-seeking expenses associated with activities that don't quite rise to the level of a trade or business. A classic example is investment costs.[9] Suppose a wealthy investor gets into a dispute with an investment advisor about the advisor's annual fee. The advisor wins the dispute, and the investor pays $100,000 in back advisory fees. The investor cannot deduct this payment under Code Sec. 162, because investing isn't a trade or business. But the investor can deduct it under Code Sec. 212, since investing is a profit-seeking endeavor.

The second "in-between" deduction is Code Sec. 165, which lets taxpayers deduct certain non-trade-or-business losses.[10] Theft losses are a typical nonbusiness Code Sec. 165 deduction.[11]

These two alternative deduction paths seem great, but they can be inferior to trade-or-business deductions because they are "below the line" deductions.[12] This means that they are deducted on Schedule A of an individual's return, instead of page 1 of Form 1040. That's not necessarily bad—but there are limitations that can make below-the-line deductions less valuable to taxpayers. One is the two-percent floor, which limits a taxpayer's Code Sec. 212 (and certain Code Sec. 165) deductions to the amount that (cumulatively) exceeds two percent of the taxpayer's adjusted gross income.[13]

Another limitation involves the dreaded AMT. Taxpayers cannot deduct Code Sec. 212 expenses (and some Code Sec. 165 losses) in determining their alternative minimum taxable income.[14] For low-income taxpayers—who almost never pay the AMT—this isn't a problem. But for others, this AMT disallowance can vitiate most of a deduction's value, because the AMT's marginal tax rate for high-income taxpayers is 28 percent—only seven percent lower than today's top individual rate.[15]

To illustrate this AMT problem, consider the disparate plights of two hypothetical taxpayers: Bert and Ernie. Bert and Ernie both have $1 million in gross income and no other deductions (assume away standard deductions, graduated rates, *etc.*). Both did unspeakable things in the past and had to repay $1 million to the parties that they injured. Bert's repayment was a business-related Code Sec. 162 deduction, but Ernie's was a Code Sec. 212 deduction. On their tax returns, Bert and Ernie both have $0 in regular taxable income

and pay no tax. Bert won't have to pay any AMT either, since his Code Sec. 162 deduction is deductible for the AMT. Ernie isn't so lucky. His deduction is not allowed for AMT purposes; thus, he will owe roughly $280,000 in AMT ($1,000,000 x 28%). In this example, there is a $0 regular-tax difference, but a $280,000 AMT difference—solely because Ernie's Code Sec. 212 deduction is an AMT preference item.

What is the take-home lesson from these two deduction limitations? It's that lawyers and tax advisors should try to tie any settlement payments to the taxpayer's trade-or-business activities, if possible. Trade-or-business deductions are often much more valuable to clients than nonbusiness deductions.

Capitalization Rules

The last basic issue to worry about when structuring a settlement agreement is the timing of the deduction. A deduction might be a perfectly good trade-or-business expense, but if the taxpayer must capitalize that cost into a parcel of land that isn't going to be sold for 30 years, it's almost a useless deduction. The capitalization rules under Code Sec. 263 are long, complex and somehow still abstruse. But the overriding principle is this: If an expense generates a "significant future benefit," it must be capitalized.[16] Thus, when capitalization is an issue, tax advisors should try to steer settlement payments toward the claims where the payment would be currently deductible.

IV. Code Sec. 162(f) Issues in Settlement Payments

Congress enacted Code Sec. 162(f) in 1969 to codify (and replace[17]) the public policy doctrine,[18] which said that taxpayers cannot deduct penalties because it would frustrate the penalties' punitive impact.[19] The statute is short and sweet, reading: "No deduction shall be allowed under [Code Sec. 162(a)] for any fine or similar penalty paid to a government for the violation of any law."[20] (The drafters of the new manufacturing deduction, Code Sec. 199, could learn a brevity lesson from Code Sec. 162(f).) But with brevity often comes unanswered questions—and stretching of the statutory language. And that's certainly the case with Code Sec. 162(f) and settlement payments.[21]

Recent Proposed Legislation

Before diving in, let's briefly review the recent proposed legislative change to Code Sec. 162(f). In 2003 and 2004, Congress considered redrafting Code Sec. 162(f) in various tax bills, but the proposals were never enacted.[22] The proposed revisions generally would have expanded Code Sec. 162(f)'s scope by loosening the "paid to the government" and "in violation of any law" requirements. (As discussed below, however, the courts already have softened these requirements substantially.) More importantly, the revision would have largely discarded the origin-of-the-claim rule, in favor of an inquiry into which parties actually received the payments.

This change was aimed largely at the securities industry, which reportedly deducted much of their well-publicized, biased research settlement payments in 2003.[23] (The proposed legislation's effective date was the day before the securities industry signed its settlement agreement—this wasn't a coincidence.) But Congress was likely also concerned about the settlement payments that will ultimately spring from the many corporate scandals of the last few years, like Adelphia. This new Code Sec. 162(f) was never enacted, however, so I won't discuss it further. Plus, another article already covered the proposed changes to Code Sec. 162(f) in excellent detail.[24]

Settlement Payments Generally

Getting back to the current Code Sec. 162(f): The first question with settlement payments is, naturally, does Code Sec. 162(f) even apply to settlement payments? On its face, it doesn't. Code Sec. 162(f) simply says, if you pay a fine or penalty, you can't deduct it. The regulations, however, explicitly state that payments in settlement of actual—or potential—fines or penalties are subject to Code Sec. 162(f),[25] and the courts have agreed to stretch the statute this far.[26] Taxpayers thus can't avoid Code Sec. 162(f) by simply settling early with the government.[27]

"Paid to a Government" Requirement

The second statutory "requirement" that's not really a requirement is that the money must be paid to a government.[28] If Code Sec. 162(f) were applied literally, taxpayers could deduct punitive payments made to a nongovernment entity. A couple of courts have mentioned this requirement when allowing a deduction,[29] but it's generally ignored by the IRS and the courts.[30] The effective rule is this: If a payment is in substance a fine, it's nondeductible—regardless of to whom it is paid.[31] In *W.E. Bailey*,[32] for instance, the Federal Trade Commission (FTC) fined Mr. Bailey roughly $1 million for violating a consent decree. But the FTC didn't actually pocket the cash; the court let

Mr. Bailey pay the money to some private litigants suing Mr. Bailey in a related case.[33] Mr. Bailey argued that he could deduct the payment because it wasn't "paid to a government."[34] He didn't convince the Ninth Circuit—it disallowed the deduction under Code Sec. 162(f), even though private parties received the cash.[35] Thus, the recipient is technically irrelevant under Code Sec. 162(f). Practically, however, who gets the money often colors the facts for the court, so tax advisors should care about who pockets their client's payment.

Lastly, note that while it doesn't matter who gets the money, the government still must be involved for Code Sec. 162(f) to apply. There are three main ways to force wrongdoers to pay money: (1) criminal fines, (2) civil fines, and (3) punitive damages. Code Sec. 162(f) applies to (1) and (2), because they are both brought by the government. But Code Sec. 162(f) doesn't apply to civil punitive damages because private litigants can't fine or punish people—even though that's supposed to be what punitive damages are doing. (The fact that a court conducts the trial doesn't make punitive damages a fine or penalty.) Others have argued that Code Sec. 162(f) should apply to punitive damages,[36] but right now it doesn't.

"Violation of Any Law" Requirement

The "violation of any law" requirement is much like the "paid to the government" requirement. It looks menacing in the statute, but it's really toothless. Taxpayers can argue that they must admit to violating a law for Code Sec. 162(f) to apply. But no cases or rulings say that, and the regulations only require potential liability.[37]

"Fine or Similar Penalty" Requirement

Since the courts and the IRS have largely written the "paid to the government" and "violation of any law" requirements out of the statute, the real action under Code Sec. 162(f) is whether a settlement payment is a "fine or similar penalty." Again, this seemingly requires the taxpayer to actually pay a specific fine before Code Sec. 162(f) kicks in. But (and this is becoming a theme) the regulations expand the requirement by stating that a fine or penalty includes amounts "[p]aid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal)."[38]

And because the underlying investigations and lawsuits are often complex, deciding whether a certain payment was made to settle a potential fine or penalty can be hard. The cases and rulings on this issue tend to meander along, and then just state a conclusion. But it's helpful to divide this penalty question into the following three issues:

- **Allocation Issue.** What portion of the payment was made to settle civil or criminal penalty claims versus what portion was compensatory?
- **Potentiality Issue.** Were the civil or criminal fines asserted sufficiently "potential" (*i.e.*, did the government have a realistic chance of winning)?
- **Penalty Issue.** Were the government's claims sufficiently punitive to constitute a fine or similar penalty?

The rest of this section fleshes out these three issues.

Allocation Issue

Step 1 is to allocate the payment (*i.e.*, decide what portion of the settlement payment applies to each claim against the taxpayer). To do this, tax advisors should closely review the asserted claims and evaluate the merits of each claim. This involves substantial nontax legal analysis, and should be done in conjunction with the defense lawyer handling the underlying case. The questions to ask are straightforward: Why was the payment made? What protections did the taxpayer get? What are the chances that each claim would have won in court? Were any charges or claims actually (or effectively) dropped? How much would the taxpayer have expected to pay?

After processing this information, the taxpayer should use the origin-of-the-claim approach to come up with a percentage allocation to apply to the payment. Consider Bad CEO's payment, for instance. After evaluating the various claims against him (and the potential dollars connected with each claim), Bad CEO might determine that his $20 million settlement payment breaks down as follows: $10 million to stop the EPA penalties, $2 million to compensate nearby homeowners for the groundwater pollution, and $8 million to settle the sexual harassment charge. And as mentioned earlier, this allocation might not match who pockets the money. The EPA may only receive $3 million of the $10 million, while it directs Bad CEO to pay the remaining $7 million to the nearby families, or an environmental charity.

But what if, after doing the allocation, the punitive component of your client's payment is very small? Can your client just ignore a release from a minor penalty and still deduct the whole payment? The argument would be a legal one, saying that the al-

location approach is the wrong legal standard to use settlement-payment cases. And while the IRS and the courts generally prefer the allocation approach,[39] a court could opt for an all-or-nothing test, where the entire payment would be deemed either compensatory or punitive, based on the overriding reason for the payment. This is called the "primary purpose test."

Some people have asserted that two cases, *J.T. Stephens*[40] and *S&B Restaurant*,[41] support this primary-purpose test. I disagree. Both cases do address issues concerning multiple payments and multi-purpose payments in the Code Sec.162(f) context. And both include language to the effect that when a payment serves both a law-enforcement and a compensatory purpose, the court's task is to determine which purpose the payment was mainly designed to serve.[42] For example, in *Stephens,* the court notes that "[o]ur review of the proceedings at Stephens' sentencing convinces [us] that Stephens' restitution payment was more compensatory than punitive."[43] At face value, these statements seem to buttress the primary purpose test. But a closer analysis of the facts in *Stephens* and *S&B Restaurant* reveals that they don't support the primary purpose test as an alternative to allocating the settlement payment among the various claims.

In *Stephens,* Jon Stephens embezzled money from Raytheon Corporation. As part of his settlement agreement, Mr. Stephens had to make two payments: a small $5,000 payment to the government for civil fines, and a large $1 million payment to Raytheon as restitution for its losses.[44] Since the court assumed that the fines were nondeductible, the only Code Sec. 162(f) issue was whether the second payment (the restitution to Raytheon) was deductible.[45] The court used a primary purpose test to determine if the Raytheon payment had a law enforcement or compensatory purpose. Relying mainly on the sentencing judge's comments that it wanted to "get Raytheon's money back," the Second Circuit held that the payment's primary purpose was compensatory, and let Mr. Stephens deduct the Raytheon payment.[46] *Stephens* does not use the primary purpose test to allocate a single payment among various claims because only the Raytheon payment was on the table.

S&B Restaurant also includes primary purpose language,[47] but, like *Stephens,* it doesn't use the test in the allocation context. S&B Restaurant was forced to pay money to settle its environmental violations. There was no allocation question in the case, as the entire payment was made to settle the Pennsylvania Department of Environmental Resources' civil claims under a state statute (there were no competing compensatory claims).[48] As such, the issue wasn't whether the payment itself served two purposes, but rather whether the underlying Pennsylvania law had both a punitive and a compensatory purpose. The Tax Court found that the statute did have both purposes, and it ruled that the primary purpose of the statute should be followed.[49] Again, this is really the Penalty Issue (discussed below), not an allocation question.

In short, I don't see much support for the primary purpose test in the allocation context. But taxpayers can still argue that it should apply. In other words, if a taxpayer makes a settlement payment that has only a small punitive component, the taxpayer can try to deduct the entire payment under the primary purpose test—just be forewarned about relying on *Stephens* and *S&B Restaurant.*

So, if these two cases don't support a primary purpose test, what legal standard will apply to settlement payments covering several claims? The IRS has indicated that the test is simply one of "reasonable allocation," and a court would likely apply this test too.[50] As a result, lawyers and tax advisors should try to characterize settlement payments as compensation for losses and not the payment of fines or penalties. Practically, this would include (1) documenting the allocation with a contemporaneous memo or spreadsheet, (2) steering the payments to victims instead of the government, (3) tying payment amounts to actual economic damages, and (4) reciting in the settlement agreement that $X is paid to compensate those who lost money.[51] Ideally, you can pick one reasonable number and have all of the documentation support that number.

Potentiality Issue

The second question is the potentiality of the fine—*i.e.*, if the case didn't settle, was the government really going to win on the fine or penalty claims? Under the regulations, an "actual or potential liability for a civil or criminal fine or penalty" must exist for Code Sec.162(f) to disallow a settlement payment.[52] And since there's no actual liability in settlement cases, the issue is just how "potential" were the government's claims.

But what is the legal standard for potentiality? Does the taxpayer have to be charged with a crime or sued under a civil statute? Or does the penalty just need to be within the realm of possibility? Unfortunately, there isn't much guidance on what standard applies. No cases have squarely discussed this potentiality issue,[53] but two IRS rulings have.[54] And the two tests seemingly promulgated by these

rulings are (1) the "being pursued" test,[55] and (2) the "contemplation of the parties" test.[56] (The courts and the IRS obviously aren't bound by the tests in these nonprecedental rulings.)

The narrow "being pursued" test—which gives taxpayers the best chance of avoiding Code Sec. 162(f)—was articulated in an unnumbered 1996 field service advice.[57] In this ruling, a corporate director made a payment in exchange for a release from civil and criminal penalty claims. In deciding if Code Sec. 162(f) applied, the IRS asked whether it appeared "that the taxpayer was being pursued for fines and penalties."[58] Based on this test, the IRS concluded that the director wasn't being pursued for any punitive claims, mainly because the director wasn't specifically named in the government's complaint (he was only included by virtue of being a director).[59] In other words, the IRS found that the director was just buying out of a potential derivative suit by the shareholders, which is a compensatory claim. Note that the IRS imported a subjective element here too. In determining whether the director was "being pursued," the revenue agent was instructed to ask one of the prosecutors if this particular defendant would have been subject to nondeductible fines, had the settlement not been reached.[60] The lesson for defense lawyers is this: Don't make the prosecutor mad at your client (even after it's over) because the prosecutor may influence your tax case down the road.

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The second legal standard for potentiality is the "contemplation of the parties" test, which is somewhat broader than the "being pursued" test. This test is from LTR 8602002, in which a corporation made a payment to a trust fund in exchange for (1) the corporation's release and the release of two employees, from an indictment for civil and criminal penalties; and (2) the government's promise not to bring any new civil or criminal penalties.[61] (Evidently, the company did other bad things for which it hadn't yet been indicted.) The IRS ruled that part of this settlement payment was attributable to the actual fines that the taxpayers were indicted for—plus the other claims that the government "could have brought" against the taxpayer.[62] Specifically, the IRS said that Code Sec. 162(f) applies to actual claims and to any "additional claims by the Government [that] were within the contemplation of the parties at the time of the plea agreement."[63]

Including uncharged claims in the allocation of settlement payments is also supported by some related case law under Code Sec. 162(a) (but no Code Sec. 162(f) cases).[64] In *G. Eisler*,[65] for instance, the Tax Court ruled that the IRS could allocate part of a settlement payment to a claim that wasn't actually ever brought. "[I]t is entirely proper to allocate a portion of the settlement payment to the negligence claim notwithstanding the fact that the pleadings were never amended to reflect that claim."[66] Thus, if a court were to look outside of Code Sec. 162(f) for guidance, it could support the position that a taxpayer was potentially liable for civil or criminal penalties, even if the taxpayer was never charged or sued under any punitive statutes.

Because this "contemplation of the parties" test is broader than the "being pursued" test, tax advisors should argue that the "being pursued" test is the proper legal standard (and should try to marshal the existing cases to support this test). It's hard to predict which test will prevail, since only private IRS rulings directly address this issue. To me, the "contemplation of the parties" test makes more sense under the expansive origin-of-the-claim doctrine, but that's obviously the IRS-favorable option.

How does a tax advisor plan for this potentiality issue? The issue here is likely to be timing. Ideally, lawyers would settle the cases before the government brings formal charges or sues. (Although even I will concede that nontax considerations will trump taxes: Until tax rates hit 100 percent, it's still better to keep your money.) And if it's too late to stop formal charges or lawsuits, try to convince the government to drop its charges before the settlement is signed. This can go a long way in showing that the taxpayer wasn't "being pursued" for penalties, and that the parties weren't contemplating punitive measures (especially if there are other, more compensatory plaintiffs).

Finally, while it's important to deny wrongdoing in the settlement agreement, tax advisors shouldn't put too much stock in this denial. The IRS has said that it doesn't really care if the taxpayer denies liability,[67] and a court would likely follow suit. (The theory is: If you really didn't do anything bad, why did you

pay?) That said, still deny everything when drafting the settlement agreement (it can't hurt).

Penalty Issue

If a taxpayer loses on these first two issues, the last arrow in the quiver is to argue that the statute that the taxpayer was released from was not punitive anyway. In other words, if (1) your client clearly paid the money for a release from the government's charges (Allocation Issue), and (2) the government probably would have won had it gone to trial (Potentiality Issue), then your client's last option is to show that the statute itself wasn't sufficiently punitive to be characterized as a fine or similar penalty. This argument won't work with some statutes, because some are clearly punitive (*e.g.,* most criminal statutes). But many statutes try to both punish perpetrators and compensate the harmed parties simultaneously, and it's not always clear what sections are serving which goals.

Also, don't confuse this dual-purpose statute question with the dual-purpose payment issue discussed earlier in the Allocation Issue section. There, the question was whether a payment was made for the purpose of obtaining the liability release under the statute and for another purpose unrelated to the statute (such as settling a class action suit). The dual-purpose statute issue, in contrast, deals with a payment made solely for relieving liability under a statute. It's just that the statute itself serves multiple purposes.

Unlike the two prior issues, there is a lot of case law and IRS guidance on this question. But how do courts determine if a statute is punitive enough? The primary standard is the "purpose of the underlying statute" test.[68] (There is no clean civil/criminal dividing line.)[69] Under this test, courts scour the statute and legislative history to determine if its purpose is law enforcement or if it's designed to compensate harmed parties. This test is also called the "functional approach" because the statute's function—not its label—governs the tax outcome.[70]

The seminal case on this issue is *Southern Pacific Transportion Co.,*[71] which summarizes this "purpose of the underlying statute" test as follows:

> If a civil penalty is imposed for purposes of enforcing the law and as punishment for the violation thereof, its purpose is the same as a fine exacted under a criminal statute and it is "similar" to a fine. However, if the civil penalty is imposed to encourage prompt compliance with a requirement of the law, or as a remedial measure to compensate another party for expenses incurred as a result of the violation, it does not serve the same purpose as a criminal fine and is not 'similar' to a fine within the meaning of section 162(f).[72]

This statutory-intent distinction set down in *Southern Pacific* has been consistently followed in subsequent case law.[73]

While the courts haven't uniformly applied this test, one law review article noticed that the courts have developed a three-part hierarchy to determine whether a payment is punitive or compensatory. The hierarchy consists of three steps: (1) the legislative intent, (2) the payment's particular circumstances, and (3) the nature of the remedy.[74] In other words, courts start with the reason that the legislature passed the statute, in the abstract. If that doesn't provide an answer, courts ask if this particular payer is really being punished by the payment. And if it's still unclear, courts look to the recipient and probe whether or not the payment compensated the recipient for losses. Each subsequent factor is only looked to only if the prior factor doesn't provide an answer. (The IRS recently indicated that it applies this approach too.[75])

Courts can often quit after step 1 in the hierarchy, because the statute's intent is evident. But how do courts determine a statute's legislative intent? Their first stop is the legislative history, to see if the enacting body answered the question for them. If a legislature clearly articulates either a punitive or compensatory reason for statute, courts end there and decide the issue (without looking at the facts of this particular payment). For example, in *Colt Industries, Inc.,*[76] the court decided that payments made under the Clean Air Act were nondeductible because Congress' legislative history showed that it designed the statute to punish violators.[77]

But if there is no legislative history (or it is unclear), courts must turn to other legislative-intent sources, such as (1) the provision's place in the larger statutory scheme (*e.g.,* was this law part of the Crime Act?), and (2) prior court decisions construing the statute in other contexts. *L.D. Huff*[78] is a good example of a court that stopped at step 1, but had to look outside of the legislative history to discover the statute's purpose. *Huff* involved the deductibility of civil fines asserted against Larry Huff, the vice president of sales for a California multi-level marketing company called Bestline. Mr. Huff had to pay $50,000 to the state of California for violating a provision of the California Business and Professions Code aimed at multi-level marketing schemes.[79] Mr. Huff challenged the IRS's assertion that this payment was a nondeductible fine under Code Sec.162(f) and lost. The

Tax Court looked to the statute's legislative history—and prior cases interpreting the statute—and found that it was "designed to penalize defendants for past illegal conduct and not to compensate injured persons."[80] The court did not review the specifics of Mr. Huff's payment (steps 2 and 3), because it held that the statute was clearly punitive.

But if a court can't find a clear statutory purpose (or if it finds many purposes), it will likely move to steps 2 and 3 in the hierarchy. These steps examine the facts and circumstances of the particular payment at issue and ask whether this specific payment was punitive or compensatory. *S&B Restaurant* demonstrates this progression. In *S&B Restaurant,* the Tax Court had to decide if a certain section of the Pennsylvania Clean Streams Law was punitive or compensatory.[81] It first probed the law's legislative history (step 1), but this didn't provide an answer because the statute was both punitive and compensatory.[82] The court then moved to steps 2 and 3, and looked at the particular circumstances of S&B Restaurant's payment.[83] "[O]ur task is to determine which purpose *the payments in question* were designed to serve."[84] Using this fact-specific test, the Tax Court found that the payments weren't punitive, and thus the payments were deductible. Other Tax Court cases have also used this approach when faced with a dual-purpose statute.[85]

H.A. True, Jr. is sort of an outliar, however. In *True,* the Tenth Circuit chose not to follow the Tax Court's three-step hierarchy when faced with a dual-purpose statute. After finding both a punitive and compensatory purpose in the legislative history, the court didn't review the specific reasons why Mr. True paid the fine. Instead, it weighed the statute's punitive and remedial purposes to determine whether the statute "on balance" was punitive or compensatory.[86] This balancing approach ignores steps 2 and 3 in the hierarchy and just stays with step 1 until it finds an answer (*i.e.*, it never looks at the facts and circumstances). Stated differently, the Tenth Circuit's test in *True* is this: If you find two purposes to a statute, don't look at the taxpayer's reason for paying this fine—just look harder at the statute and pick the legislative purpose that seems the most important.

On the planning front, there aren't as many tools with this Penalty Issue as there are with the prior two issues (it's hard to rewrite legislative history). But there are some tricks to try. First, tax advisors and lawyers should pay close attention to whether the particular statutes involved are punitive or compensatory (read the legislative history, review cases decided under the statute, *etc.*). And if the statutes that the client is sued under are split (some remedial, some punitive), try to get just the punitive claims dropped. If this is impossible, ask the government lawyers to at least to drop the punitive claims once the parties have agreed on the payment terms, but before they sign the settlement agreement. And always try to tie the payments to the least punitive claims, if possible.

> Things can get crazy when lawyers are negotiating a settlement in a complex case. The tax consequences of the payment can be easily forgotten. Good lawyers shouldn't ignore taxes.

V. LTR 200502041

The most recent guidance on Code Sec. 162(f) is LTR 200502041,[87] which includes a detailed discussion of the Allocation Issue and the Penalty Issue. The basic facts are as follows: A company billed the U.S. government for unauthorized and unneeded services. The government found out and threatened legal action under the False Claims Act (FCA). After substantial investigation and negotiation, the company agreed to make a lump-sum payment in exchange for a total release from FCA charges. The company was potentially liable under three specific provisions: (1) a small civil fine; (2) repayment to the government, which was trebled under the statute; and (3) reimbursement of the government's investigation costs.

The IRS ruled that only part of the payment was deductible (the company had deducted the entire payment). The analysis focused on two main issues. First, it considered whether the trebled damages provision was a nondeductible fine (*i.e.*, the Penalty Issue). The IRS went through all three steps to determine if this provision was punitive or compensatory. It initially evaluated the FCA's language and legislative history. It next looked at general nontax cases interpreting the FCA's multiple damages provisions. The IRS then reviewed the specific reasons why the company paid this fine. Lastly, the IRS looked at *Talley Industries, Inc.*,[88] a prior Code Sec. 162(f) case under the FCA.[89] Based on all of this, it decided that the treble damages were a punitive measure and thus nondeductible.

The second big issue analyzed in LTR 200502041 was the allocation of the company's payment be-

tween the three classes of FCA claims (*i.e.*, the Allocation Issue). This was a highly factual question, in which the IRS scrutinized the details of the parties' negotiations. In particular, the IRS watched the changes in the parties' allocation spreadsheet, which was adjusted as the negotiations progressed. In the end, the IRS based its allocation decision on the final pre-settlement allocation spreadsheet.

There are a lot of planning lessons to learn from this ruling, but here are five quick tips from LTR 200502041:

- **Always recite that the payment is for compensatory claims.** While courts love to say that substance (not form) governs origin-of-the-claim cases, it still never hurts to have the form in your favor. In settlement cases, the form usually means the settlement agreement. So try to recite in the settlement agreement that the payment is for the government's compensatory claims. Sometimes the government agency that you're dealing with will know about this issue, but often they won't (or won't care because they just want the money).
- **Prepare a contemporaneous allocation memo or spreadsheet.** Most tax controversies arise years after the parties sign the settlement agreement and pay the money. Thus, courts and the IRS are skeptical about after-the-fact allocations. Timely allocation schedules carry more weight. And even if the taxpayer's allocations aren't upheld, they can at least create a favorable starting point, which may lead to a good outcome. In LTR 200502041, for instance, the IRS adopted the parties' contemporaneous allocation memo without change.[90]
- **Don't rely on a denial of wrongdoing.** Taxpayers making large settlement payments will almost always deny any wrongdoing (*e.g.*, the securities industry in the biased-research scandal). The IRS knows this, and thus doesn't put much stock in the taxpayer's denial—even if it's in the settlement agreement. This doesn't mean that taxpayers shouldn't deny everything, just know that it won't help much on the tax side.
- **Don't acknowledge that multiple damages apply.** The biggest lesson from LTR 200502041 is that multiple damages paid to a government are not deductible.[91] (Multiple damages exist when compensatory damages are automatically doubled or tripled to punish the payer.) This multiple damages rule seems inconsistent with the fact that taxpayers can deduct civil punitive damages (after all, punitive damages aren't even based on actual compensatory damages). But that seems to be the law right now, so tax advisors should try to steer allocations away from multiple damages paid to a government.
- **Characterize part of the payment as a reimbursement of the government's investigation costs.** One of the few high points for taxpayers in LTR 200502041 is that the IRS said that payments to compensate the government for its investigation costs are deductible (pre-settlement interest and relator fees were also lumped in).[92] In the ruling, however, the IRS said that the taxpayer couldn't prove that part of the payment went to these costs, so it didn't allow the deductions. But the lesson remains: Tax advisors should try to allocate part of the payment to investigation costs (if applicable) to maximize the client's deduction.

VI. Conclusion

Things can get crazy when lawyers are negotiating a settlement in a complex case. The tax consequences of the payment can be easily forgotten. Good lawyers shouldn't ignore taxes. Code Sec. 162(f) and the AMT can rob taxpayers of their deduction, which can drastically alter the client's after-tax outcome. And while the true merits of the claims should govern the tax picture, there are many little things that lawyers and tax advisors can do to influence how much the client will ultimately be able to deduct. It's a disservice to clients to ignore these tricks—and the client's tax-controversy lawyer down the road will thank you for doing them.

Endnotes

1 Grant and Solomon, *Adelphia to Pay $715 Million in 3-Way Settlement*, Wall St. J., Apr. 26, 2005.

2 All "Code Sec." references are to the Internal Revenue Code of 1986, as amended, unless otherwise noted.

3 *W.M. Hort*, SCt, 41-1 USTC ¶9354, 313 US 28; *D. Gilmore*, SCt, 63-1 USTC ¶9285, 372 US 39.

4 The issues are related but line up differently for corporate payers (*e.g.*, no two-percent floor and a different AMT scheme). This section is aimed at individual taxpayers.

5 Code Sec. 162.

6 Code Sec. 262.

7 *Compare D.F. Kelly*, 77 TCM 1501, TC Memo. 1999-69, Dec. 53,278(M) (holding that legal costs to defend a sexual assault charge are nondeductible), *with J.W. Clark*, 30 TC 1330, Dec. 23,190 (1958) (letting the taxpayer deduct costs of defending a sexual assault charge in a business setting), *nonacq.*, 1959-1 CB 6 (1959). *See also W.F. Tellier*, SCt, 66-1 USTC ¶9319, 383 US 687.

8 *C.A. Ostrom*, 77 TC 608, 611, Dec. 38,253 (1981) (holding that a company president could deduct damage payments related to false representations to an investor as a business expense of being an employee of the company). *See also J.E. Caldwell & Co.*,

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CA-6, 56-2 USTC ¶9759, 234 F2d 660, *rev'g*, 24 TC 597, Dec. 21,102 (1955); *Helvering v. Hampton*, CA-9, 35-2 USTC ¶9562, 79 F2d 358.

[9] *See, e.g., F.R. Mayer*, 67 TCM 2949, TC Memo. 1994-209, Dec. 49,838(M), at 15.

[10] Code Sec. 165(a), (c). Code Sec. 165(c)(1) allows taxpayers to deduct trade-or-business losses, which are deductible above the line.

[11] Code Sec. 165(c)(3).

[12] Code Sec. 62. In other words, they are deducted "from" adjusted gross income (AGI).

[13] Code Sec. 67(a).

[14] Code Sec. 56(b)(1)(A)(i).

[15] Code Sec. 55(b)(1)(A)(i)(II); Code Sec. 1(i)(2).

[16] *INDOPCO, Inc.*, SCt, 92-1 USTC ¶50,113, 112 SCt 1039, 503 US 79.

[17] S. REP. No. 91-552, 91st Cong., 1st Sess. 273-75 (1969); *reprinted in* 1969-3 CB 423, at 596–98.

[18] *See, e.g., Tank Truck Rentals, Inc.*, SCt, 58-1 USTC ¶9366, 356 US 30, at 35–36 (disallowing the deduction for fines paid by a trucking company for violating weight restrictions).

[19] *Supra* note 17.

[20] Code Sec. 162(f). The statute literally only applies to Code Sec. 162 deductions, but the courts have also applied it to nonbusiness deductions. *See J.T. Stephens*, CA-2, 90-2 USTC ¶50,336, 905 F2d 667 (stating "Congress can hardly be considered to have intended to create a scheme where payment would not pass muster under Section 162(f), but would still qualify for deduction under Section 165"), *rev'g*, 93 TC 108, Dec. 45,875 (1989).

[21] For further discussion and analysis of Code Sec. 162(f), *see* the following articles: Burgess J.W. Ruby and William L. Ruby, *Moral Righteousness and Tax Deductions*, 105 TAX NOTES 1115 (Nov. 22, 2004); William L. Ruby and Burgess J.W. Ruby, *Tax Consequences of Settlements with Government Agencies*, 95 TAX NOTES 565 (Apr. 22, 2002); Kimberly A. Pace, *The Tax Deductibility of Punitive Damage Payments: Who Should Ultimately Bear The Burden for Corporate Misconduct*, 47 ALA. L. REV. 825 (Spring 1996); Jacob L. Todres, *Internal Revenue Code Section 162(f): An Analysis and Its Application to Restitution Payments And Environmental Fines*, 99 DICK. L. REV. 645 (Spring 1995); F. Philip Manns, Jr., *Internal Revenue Code Section 162(f): When Does The Payment of Damages to a Government Punish The Payor?* 13 VA. TAX REV. 271 (Fall 1993); Charles A. Borek, *The Public Policy Doctrine and Tax Logic: The Need for Consistency in Denying Deductions Arising from Illegal Activities*, 22 U. BALT. L. REV. 45 (Fall 1992); *The Smugglers' Blues: Wood v. United States and The Resulting Horizontal Inequity Among Criminals in the Allowance of Federal Income Tax Deductions*, 11 VA. TAX REV. (Winter 1992); Robert T. Manicke, *A Tax Deduction for Restitutionary Payments? Solving The Dilemma of The Thwarted Embezzler*, 1992 U. ILL. L. REV. 593 (1992). James W. Colliton, *The Tax Treatment of Criminal and Disapproved Payments*, 9 VA. TAX REV. 273 (1989).

[22] Joint Committee on Taxation, *Description of the Chairman's Mark of the "Good Government Act of 2004"* (JCX-2-04), Jan. 29, 2004. For prior versions of this proposal, *see* S. 1637, §423; Joint Committee on Taxation, *Description of the Chairman's Mark of the "Jumpstart Our Business Strength (JOBS) Act"* (JCX-83-03), Sept. 26, 2003, at 67–69; Committee on Finance, *Report on "Jumpstart Our Business Strength (JOBS) Act,"* Nov. 7, 2003, at 130–32; Joint Committee on Taxation, *Description of the "Small Business and Farm Economic Recovery Act"* (JCX-88-02), Sept. 17, 2002, at 88–89; §333 of the Senate amendment to H.R. 2, dated May 15, 2003; Committee on Finance, *Technical Explanation of Provisions Approved by the Committee on May 8, 2003*, May 2003, at 70–72.

[23] Zuckerman, *Pain of Wall Street Settlement to Be Eased by U.S. Taxpayers*, WALL ST. J. (Feb. 13, 2003). For a detailed analysis, *see* Robert W. Wood, *Should the Securities Industry Settlement be Deductible?* 99 TAX NOTES 101 (Apr. 7, 2003).

[24] Yoav Wiegenfeld, *Increasing the Cost of Settlements: Proposed Legislation Would Expand the Fine and Penalty Nondeductibility Rule*, 101 TAX NOTES 1341 (Dec. 15, 2003).

[25] Reg. §1.162-21(b)(l)(iii).

[26] *S&B Restaurant Inc.*, 73 TC 1226, Dec. 36,857 (1980).

[27] *Id.*, at 1234.

[28] Code Sec. 162(f); Reg. §1.162-21(a).

[29] *J.T. Stephens*, CA-2, 90-2 USTC ¶50,336, 905 F2d 667, *aff'g*, 93 TC 108, Dec. 45,875 (1989); *R.W. Spitz*, DC Wis., 77-2 USTC ¶9501, 432 FSupp 148.

[30] *See, e.g.*, Rev. Rul. 79-148, 1979-1 CB 93 (holding that Code Sec. 162(f) applies to payments made to a charity).

[31] *H. Waldman*, 88 TC 1384, Dec. 43,932, at 1389–90 (1987) (holding that restitution payments to theft victims satisfies the paid-to-a-government requirement), *aff'd*, CA-9, 88-2 USTC ¶9424, 850 F2d 611; *Allied-Signal*, CA-3, 95-1 USTC ¶50,151 (payments to a fund established to benefit the public are "paid to a government"), *aff'g TC in an unpublished opinion*, 63 TCM 2672, TC Memo. 1992-204, Dec. 48,133(M); Rev. Rul. 81-151, 1981-1 CB 74 (reimbursements to a corporate officer's employer for illegal campaign contributions are a nondeductible fine). Essentially, this is the rule that the proposed Code Sec. 162(f) redraft tried to change, replacing it with a rule that explicitly looks at who received the money to determine the tax results.

[32] *W.E. Bailey*, CA-6, 85-1 USTC ¶9239, 756 F2d 44.

[33] *Id.*, 756 F2d, at 47.

[34] *Id.*, 756 F2d, at 46–47.

[35] *Id.*, 756 F2d, at 47.

[36] Kimberly A. Pace, *The Tax Deductibility of Punitive Damage Payments: Who Should Ultimately Bear the Burden for Corporate Misconduct?* 47 ALA. L. REV. 825 (Spring 1996); Catherine M. Del Castillo, *Should Punitive Damages Be Nondeductible? The Expansion of The Public Policy Doctrine*, 68 TEX. L. REV. 819 (Mar. 1990).

[37] Reg. §1.162-21(b)(l)(iii).

[38] *Id.*

[39] *See, e.g.*, 1996 FSA LEXIS 491, at 13 (holding that in deciding whether Code Sec.162(f) applies to a settlement payment, the revenue agent should allocate between deductible and nondeductible purposes).

[40] *Stephens, supra* note 29.

[41] *S&B Restaurant, supra* note 26.

[42] *Stephens, supra* note 29, 905 F2d, at 673; *S&B Restaurant, supra* note 26, 73 TC, at 1232.

[43] *Stephens, supra* note 29, 905 F2d, at 673.

[44] *Stephens, supra* note 29, 905 F2d, at 668–69.

[45] *Stephens, supra* note 29, 905 F2d, at 673.

[46] *Id.*

[47] *S&B Restaurant, supra* note 26, 73 TC, at 1232 (stating that "[t]he Clean Stream Law has a dual purpose and our task is to determine which purpose the payments in question were designed to serve").

[48] *S&B Restaurant, supra* note 26, 73 TC, at 1228–30.

[49] *S&B Restaurant, supra* note 26, 73 TC, at 1232. Note that this dual-purpose statute versus dual-purpose payment issue is muddied somewhat by language suggesting that payments can be for different purposes under the same statute.

[50] 1996 FSA LEXIS 491 (Apr. 26, 1996), at 13.

[51] *See generally B.E. McKay*, 102 TC 465, 482–83, Dec. 49,736 (1994), *vac'd and rem'd on other grounds*, CA-5, 96-1 USTC ¶50,279, 84 F3d 433. Also, be careful what you write in letters and what the client says in depositions, *etc.*, because the IRS has said that anything is fair game in deciding this allocation issue. 1996 FSA LEXIS 491, at 7.

[52] Reg. §1.162-21(b)(1)(iii) (emphasis added).

[53] One Tax Court case, *S&B Restaurant, supra* note 26, 73 TC, at 1234, dealt with this issue *in dicta*, however. It didn't lay

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down a test, but it did side with the IRS guidance in stating that there is no requirement of a legal proceeding for Code Sec. 162(f) to apply. The court justified this statement theoretically by pointing out that such a requirement may encourage taxpayers to "pay early and get the deduction."

[54] 1996 FSA LEXIS 491 (Apr. 26, 1996); LTR 8602002 (Sept. 30, 1985).
[55] 1996 FSA LEXIS 491.
[56] LTR 8602002 (Sept. 30, 1985).
[57] 1996 FSA LEXIS 491.
[58] 1996 FSA LEXIS 491, at 28.
[59] 1996 FSA LEXIS 491, at 10–11.
[60] 1996 FSA LEXIS 491, at 13.
[61] LTR 8602002, at 1–2.
[62] LTR 8602002, at 10.
[63] LTR 8602002, at 20 (emphasis added). The LTR also mentions a "threatened action" test, which could be adopted by a court. LTR 8602002, at 10.
[64] *W.B. DeMink*, CA-9, 71-2 USTC ¶9657, 448 F2d 867; *see also* Rev. Rul. 80-119, 1980-1 CB 40.
[65] *G. Eisler*, 59 TC 634, Dec. 31,835 (1973), *acq.*, 1973-2 CB 1.
[66] *Eisler, id.*, 59 TC at 641.
[67] FSA 200210001, 2001 FSA LEXIS 236 (Nov. 19, 2001), at 7–8. LTR 200502041 (Oct. 26, 2004), at 6.
[68] *Todres, supra* note 21, 99 DICK. L. REV., at 669.
[69] Code Sec. 162(f). *See also Adolf Meller Co.*, CtCls, 79-2 USTC ¶9415, 600 F2d 1360, 220 CtCls 500, *citing* S. REP. NO. 92-437, 92d CONG. 1st SESS. (1971), 1972-1 CB 559, 600.
[70] For a detailed discussion of this test and its history, see Manns, *supra* note 21, 13 VA. TAX REV., at 280–88.
[71] *Southern Pacific Transportion Co.*, 75 TC 497, Dec. 37,600 (1980).
[72] *Southern Pacific*, 75 TC, at 652.
[73] *See, e.g., Talley Industries, Inc.*, CA-9, 97-1 USTC ¶50,486, 116 F3d 382; *J.T. Stephens*, CA-2, 90-2 USTC ¶50,336, 905 F2d 667.
[74] Manns, *supra* note 21, 13 VA. TAX REV., at 288–89.
[75] FSA 200210011 (Nov. 19, 2001), at 10–11.
[76] *Colt Industries, Inc.*, ClsCt, 86-2 USTC ¶9749, 11 ClsCt 140, *aff'd on other grounds*, CA-FC, 89-2 USTC ¶9450, 880 F2d 1311.
[77] *Colt Industries*, 11 ClsCt, at 144 (summarizing its analysis of the legislative history by stating that "[t]he facts regarding the punitive nature of the civil penalty provisions outweigh the references in the report to a 'remedial' or 'deterrent' purpose"); *see also Mason and Dixon Lines*, CA-6, 83-1 USTC ¶9385, 708 F2d 1043 (holding that liquidated damages for violating truck weight limits were compensatory because of the structure and language of the statute).
[78] *L.D. Huff*, 80 TC 804, Dec. 40,068 (1983).
[79] *Huff*, 80 TC, at 811.
[80] *Huff*, 80 TC, at 824.
[81] *S&B Restaurant*, 73 TC, at 1232.
[82] *S&B Restaurant*, 73 TC, at 1231–32.
[83] *S&B Restaurant*, 73 TC, at 1232–33.
[84] *S&B Restaurant*, 73 TC, at 1232 (*emphasis added*).
[85] *See, e.g., H. Waldman*, 88 TC 1384, at 1387, Dec. 43,932 (1987), *aff'd*, CA-9, 88-2 USTC ¶9424, 850 F2d 611; *Middle Atl. Distrib., Inc.*, 72 TC 1136, at 1145, Dec. 36,335 (1979).
[86] *H.A. True, Jr.*, CA-10, 90-1 USTC ¶50,062, 894 F2d 1197, at 1205.
[87] LTR 200502041 (Oct. 26, 2004).
[88] *Talley Industries, Inc., supra* note 73.
[89] LTR 200502041, at 19–20.
[90] LTR 200502041, at 25–30.
[91] Before Code Sec. 162(f), the IRS ruled that treble damages were deductible. Rev. Rul. 64-224, 1964-2 CB 52.
[92] LTR 200502041, at 33–34.