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January 28, 2021

Chair
Ranking Member
Committee on Finance
United States Senate

The Honorable Richard Neal
Chairman
The Honorable Kevin Brady
Republican Leader
Committee on Ways and Means
House of Representatives

Subject: Department of the Treasury, Internal Revenue Service: Denial of Deduction for Certain Fines, Penalties, and Other Amounts; Related Information Reporting Requirements

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Department of the Treasury, Internal Revenue Service (IRS) entitled “Denial of Deduction for Certain Fines, Penalties, and Other Amounts; Related Information Reporting Requirements” (RIN:1545-BO67). We received the rule on January 17, 2021. It was published in the *Federal Register* as final regulations on January 19, 2021. 86 Fed. Reg. 4970. The stated effective date of the rule is January 14, 2021.

This final rule, according to IRS, provides guidance on section 162(f) of the Internal Revenue Code (Code), 26 U.S.C. § 162(f), as amended in 2017, concerning the deduction of certain fines, penalties, and other amounts. IRS stated that the rule also contains final regulations providing guidance relating to the information reporting requirements under new section 6050X of the Code, 26 U.S.C. § 6050X, with respect to those fines, penalties, and other amounts. According to IRS, the rule affects taxpayers that pay or incur amounts to, or at the direction of, governments, governmental entities or certain nongovernmental entities treated as governmental entities relating to the violation of any law or investigations or inquiries by such governments, governmental entities, or nongovernmental entities into the potential violation of any law. IRS stated that the rule also affects governments, governmental entities, and nongovernmental entities subject to the related reporting requirements.

The Congressional Review Act (CRA) requires a 60-day delay in the effective date of a major rule from the date of publication in the *Federal Register* or receipt of the rule by Congress, whichever is later. 5 U.S.C. § 801(a)(3)(A). The 60-day delay in effective date can be waived, however, if the agency finds for good cause that delay is impracticable, unnecessary, or contrary to the public interest, and the agency incorporates a statement of the findings and its reasons in the rule issued. 5 U.S.C. § 808(2). The Department of the Treasury and IRS stated

that they found, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest.

IRS stated that, as demonstrated by the wide variety of public comments in response to the proposed regulations, taxpayers and governments and governmental entities continue to express uncertainty regarding the proper application of the relevant statutory rules under section 162(f) and section 6050X. The rule, according to IRS, provides crucial guidance for taxpayers and governments and governmental entities on how to apply the relevant statutory rules. IRS stated that in certain cases, failure to comprehend the proper application of the requirements of section 162(f) can prevent taxpayers from claiming appropriate deductions, resulting in them paying potentially higher taxes than required during a time of economic difficulty. In addition, IRS stated that governments and governmental entities will require several months to update or develop data collection and reporting systems to comply with the rules under section 6050X. However, IRS stated that governments and governmental entities will need to know that the rule is effective before incurring necessary costs to timely comply with the rule. Accordingly, the Department of the Treasury and IRS stated that they determined that the rule will take effect on the date of filing for public inspection in the *Federal Register*.

Enclosed is our assessment of IRS's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shari Brewster, Assistant General Counsel, at (202) 512-6398.

A handwritten signature in cursive script that reads "Shirley A. Jones".

Shirley A. Jones
Managing Associate General Counsel

Enclosure

cc: Carrie E. Mudd
Director, Legal Processing Division
Department of the Treasury

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE
ENTITLED
“DENIAL OF DEDUCTION FOR CERTAIN FINES, PENALTIES, AND
OTHER AMOUNTS; RELATED INFORMATION REPORTING REQUIREMENTS”
(RIN: 1545-BO67)

(i) Cost-benefit analysis

The Internal Revenue Service (IRS) stated that, with respect to section 162(f) of the Internal Revenue Code (Code), this final rule provides definitions that clarify for taxpayers which amounts paid or incurred may be deductible under the statute. Also, IRS stated that the rule clarifies how the taxpayer meets the establishment requirement and how the order or agreement meets the identification requirement. IRS determined that the burden reduction associated is modest and the rule is unlikely to affect economic decision-making.

IRS stated that, with respect to section 6050X of the Code, the rule provides certainty and consistency for affected governments and governmental entities by defining and clarifying the statute’s terms and rules. Most importantly, according to IRS, the rule increases the reporting threshold from \$600 to \$50,000, thereby eliminating information reporting requirements. IRS stated that this reduction in compliance burden is the only meaningful economic effect of the rule. IRS further stated that the rule does not have meaningful effects on the tax liability of taxpayers, the deductibility of amounts paid to, or at the directions of, governments and governmental entities, or the incentive for individuals or businesses to engage in violations of the law.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

The Secretary of the Treasury certified that this final rule will not have a significant economic impact on a substantial number of small entities within the meaning of RFA.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

IRS determined that this final rule does not include any federal mandate that may result in expenditures in any one year by state, local, or tribal governments, or by the private sector in excess of \$100 million in 1995 dollars, updated annually for inflation.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*

On May 13, 2020, IRS published a proposed rule. 85 Fed. Reg. 28524. IRS received written comments in response to the proposed rule. IRS responded to comments in this final rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

IRS determined that this final rule contains new information collection requirements on Form 1098-F (Office of Management and Budget (OMB) Control Number 1545-2284) and stated that Form 1098-F is approved through January 31, 2023. IRS estimated an annual burden reduction of \$74 million.

Statutory authorization for the rule

IRS promulgated this final rule pursuant to section 7805 of title 26, United States Code.

Executive Order No. 12866 (Regulatory Planning and Review)

IRS stated that this final rule has been designated by the Office of Information and Regulatory Affairs as subject to review under the Order pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and OMB regarding review of tax regulations.

Executive Order No. 13132 (Federalism)

IRS determined that this final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law, within the meaning of the Order.