Ralph Levy, Jr.

Recent IRS Rulings Could Have Important Implications for Settlements of False Claims Act Violations

Ralph Levy, Jr. is of counsel in the Nashville, Tenn. office of Dickinson Wright PLLC. He can be reached at 615/620-1733 or by email at rlevy@dickinsonwright.com. Dickinson Wright PLLC is a full-service law firm with over 350 attorneys with offices in Michigan, Tennessee, Arizona, Nevada, Ohio, Kentucky, Washington, D.C., and Toronto, Ontario.

Rulings Illustrate Importance of Identifying the Purpose of Payments

In a previously published *Journal of Health Care Compliance (JHCC)* article, the author addressed the implications of *Fresenius Medical Care Holdings, Inc. v. United States*, No. 13-2144, 2014 U.S. App. LEXIS 15536 (1st Cir. Aug. 13, 2014), a 2014 First Circuit appellate decision on the deductibility for federal tax purposes of payments made by health care providers to resolve claims under the False Claims Act (FCA).[1] Two recent rulings by the Internal Revenue Service (IRS) in regard to payments made by taxpayers to resolve alleged violations of criminal statutes (and not under the FCA) provide additional guidance to health care providers in analyzing the tax consequences of payments to resolve False Claims Act investigations. In one ruling, payments to resolve a federal criminal investigation were found to be deductible. In the other ruling, payments of this type were found to be nondeductible.

In ECC 201513003, the National Office of the IRS found that payments made by a taxpayer as a forfeiture payment under a Deferred Prosecution Agreement (DPA) entered into by the federal government with the taxpayer that resolved an investigation against the taxpayer for violations of several federal criminal statutes related to money laundering and related offenses were not deductible.

In the facts that underlie this ruling, the DPA specifically provided that the payments made by the taxpayer were in lieu of a forfeiture which was permitted under the federal criminal statutes under which the taxpayer was being investigated. More importantly, the IRS found that even though the Department of Justice intended

to use a portion of the forfeited funds to compensate victims of the crime, the DPA specifically indicated that the payment was a (nondeductible) forfeiture and did not require that the monies paid to the U.S. government be used to compensate the victims of the crimes alleged to have been committed by the taxpayer as (deductible) restitution. Perhaps a more specific reference in the DPA as to the nature of the payments would have resulted in a finding in favor of the taxpayer. This ruling points out the importance that the settlement agreement that resolves an FCA claim characterize the payments as restitution rather than as a nondeductible penalty or forfeiture so as to preserve deductibility of the payments for federal tax purposes.

In the second action by the IRS, PLR 20158026, an employee of a company that sold products, including a product the sales of which were the responsibility of the taxpayer, entered into a cooperation agreement as part of resolution of a criminal prosecution by the U.S. government against the taxpayer and its employer and also pled guilty to two crimes. As part of the plea agreement, the taxpayer agreed to pay restitution in an amount to be determined by the sentencing court. The sentencing court found that the taxpayer was required to make a restitution payment of $4x to the government in part to compensate the U.S. government for its $3x actual loss. Moreover, the sentencing court found that the payments were intended to be in the nature of restitution, *i.e.*, to compensate the federal government for its economic loss.

The Service cited several factors in reaching its decision to allow the taxpayer to deduct the payment made by the taxpayer to the government. For example, the plea agreement clearly indicated the payment was intended to compensate the U.S. government for actual losses it had incurred as a result of taxpayer's actions. Moreover, under the plea agreement, the taxpayer agreed to pay a separate (nondeductible) fine. Finally, the restitution payment was not made in lieu of a forfeiture and took place at a different time than the sentence of imprisonment by the sentencing court.

The Service applied the "origin of the claim" test as additional support for its conclusion that the payments made by the taxpayer in PLR 201528026 related to the taxpayer's activities in the ordinary course of the business of the taxpayer's employer and thus were deductible "ordinary and necessary business expenses."

These two rulings illustrate the importance of specifying that payments made to resolve an investigation of violations of the FCA by a health care provider are for restitution and not as a forfeiture or a penalty. In ECC 201513003, the DPA specifically characterized the payments as a forfeiture (and thus not deductible). By contrast, in PLR 201528026, the plea agreement indicated that the payments made were in the nature of restitution (and thus deductible).

In both the ECC and the PLR, the U.S. government and the taxpayer entered into agreements (a DPA in the ECC and a plea agreement in the PLR). By contrast, in the *Fresenius Medical Holdings* case discussed in this author's prior article referred to above, the U.S. government specifically refused to address the tax deductibility of the payments made by the taxpayer that were required to be made under the settlement agreement. In reaching its decision in *Fresenius Medical Holdings*, the First Circuit Court of Appeals referred to evidence of documentation of the nature of the payments to the government even when the U.S. government refused to allocate the payments one way or another.

Endnote:

1. "Recent Case Upholds Deductibility of Payments to Settle False Claims Act Allegations", *Journal of Health Care Compliance*, November/December 2014.

Reprinted from Journal of Health Care Compliance, Volume 17, Number 6, November-December 2015,
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