大成 DENTONS

Jeffry J. Erney
Partner

jeffry.erney@dentons.com
D +1 202 496 7511

Dentons US LLP
1900 K Street, NW
Washington, DC 20006
United States

dentons.com

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Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2018-23)
Room 5203
P.O. Box 7602
Ben Franklin Station
Washington, D.C. 20444

VIA E-MAIL

RE: Request for Comments for Proposed Regulations Under Section 162(f) of the Internal Revenue Code of 1986.

We are pleased to provide these comments with respect to Notice 2018-23 and appreciate the opportunity to provide our input. In Notice 2018-23, the Internal Revenue Service requested comments from the public regarding the recent revisions to section 162(f) of the Internal Revenue Code and specifically request comments on the definition of key terms in section 162(f).

While our comment is focused on the scope of 162(f) as it pertains to Medicare overpayments, the issues we identify, and recommend regulation on, would be equally applicable to all those entities that regularly conduct business with a government that sometimes results in the return of monies previously received.[1]

I. Purpose of Section 162(f)

The purpose of Section 162(f) has not changed since it was first introduced into the Code in 1969. Section 162(f) was originally added to the Code to codify the "frustration of public policy" doctrine. *Nacchio v. United States*, 824 F.3d 1370, 1375 (Fed. Cir. 2016). Under that policy, a deduction is disallowed if allowing it would otherwise "frustrate sharply defined national or state policies proscribing particular types of conduct." *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30, 34 (1958). Section 162(f) thus disallowed deductions for fines and

[1] The authors of this comment are recognized experts in the area of tax law and healthcare. Jeffrey J. Erney is the Chair of the National Tax Controversy Practice at Dentons with over 30 years of experience representing clients in complex, high-stakes tax matters. Christopher G. Janney is a partner in the Health Care and Life Sciences practice at Dentons with over 25 years representing the healthcare industry. Peter J. Anthony is a senior managing associate at Dentons and has nearly a decade of experience representing clients in complex, high-stakes tax controversy matters.

penalties because otherwise it would reduce the "sting" of the penalty imposed by the state and frustrate sharply defined state policies. *Id.* at 36. From this, in determining the scope of a fine or penalty, courts drew a distinction between a non-deductible punitive payment and a deductible compensatory one. *See, e.g., Nacchio*, 824 F.3d at 1376.

Nothing in the legislative history of the Tax Cuts and Jobs Act ("TCJA") suggests Congress intended to change that purpose when it revised section 162(f). The section still permits a taxpayer to claim deductions for restitution payments. Instead, it appears that Congress sought to simplify the section 162(f) analysis by eliminating the unclear, often-litigated distinction between punitive and compensatory payments. It also sought to simplify the administration and enforcement of this provision by introducing an identification requirement and a requirement that an information return be filed with the IRS.

Thus, any regulations issued under the new section 162(f) should be aimed at remaining faithful to that purpose of only disallowing a deduction when allowing it would otherwise reduce the "sting" of that payment and frustrate well defined governmental policies.

Unfortunately, in its current form, section 162(f) covers far more than that. Now, section 162(f) would deny a deduction for routine repayments made by health care providers to Medicare. This is far beyond the scope of what Congress intended.

II. Medicare Overpayments

Under recently finalized regulations, a provider who discovers an overpayment is under a legal obligation to report the overpayment and return it to Medicare within 60 days. A provider may also be required to return an overpayment in response to a notification from a government agency. An overpayment is defined as "any funds that a person has received or retained under title XVIII of the Act to which the person, after applicable reconciliation, is not entitled under such title." 42 C.F.R. § 401.303. It is a payment received from Medicare that a provider was not entitled to as a matter of law.

When an overpayment is discovered, or a provider is notified, a provider may simply make an immediate payment to the relevant government agency and there is no further communication or documentation between the government and the provider on the matter. In other cases, an internal or external investigation ensues, which may result in a payment, settlement or litigation.

As Medicare is a complex system serving over 56 million people, overpayments refunded to Medicare are common. According to the Centers for Medicare & Medicaid ("CMS"), Medicare expenditures in 2016 totaled $672.1 billion. *See* https://www.cms.gov/research-statistics-data-and-systems/statistics-trends-and-reports/nationalhealthexpenddata/nhe-fact-sheet.html (last visited May 17, 2018). This amount constituted reimbursement to hospitals, physicians, and a host of other providers for furnishing health care services to Medicare beneficiaries. Each year, CMS audits a sample of claims submitted by providers to Medicare under its fee-for-service program and, based on this audit, announces an "improper payment rate." For 2016, the improper payment rate was 11 percent. In other words, in CMS's view, approximately 11 percent of all payments made to providers in 2016 for services furnished to Medicare beneficiaries should not have been made. In most cases, the overpayments were the result of clerical or other inadvertent coding or billing mistakes on the part of providers. In a few cases, the overpayments were the result of fraud.

In all events, applying this improper payment rate to total Medicare expenditures in 2016 would result in overpayments by Medicare to providers of approximately $67 billion. A substantial amount of these overpayments are returned by providers to Medicare each year, either pursuant to voluntary self-disclosures or in connection with government-initiated audits, inquiries, or litigation. All those returned overpayments are now swept into section 162(f)'s ambit.

II. How Section 162(f) Now Applies to Medicare Overpayments and Imposes a New Burden on CMS

Under prior law, section 162(f) would not have denied providers a deduction for these Medicare overpayments that resulted from good faith billing mistakes or omissions as repayment would not have amounted to a "fine or penalty."

Now it does. These good faith Medicare overpayments are now subject to section 162(f) with its attendant identification and return filing requirements. When a provider returns an overpayment to a government agency, it has made a payment to the government that "relates to" a "violation of law." As explained above, a Medicare overpayment, regardless of the reason for it, is a violation of law as it is money received that the provider would not have otherwise been entitled to under federal statutes or regulations.

While the overpayment would constitute restitution, in order for providers to be able to claim the deduction, it must now be identified as such in a "court order or settlement agreement." But, as explained above, in many cases when a provider returns an overpayment to the government it sends a check, which the government cashes, or transfers the money to the government. There is no settlement agreement. There is no court order.

A provider cannot easily rectify this by demanding a settlement agreement. They are in the unfortunate position of being under a legal obligation to return the overpayment and thus have no leverage to insist upon one.

Thus, without further regulation, providers could lose billions in deductions. This could, in turn, have a real and immediate impact on the cost of health care in the United States. This is not something that Congress clearly intended when it amended section 162(f).

Even if governments are willing to execute settlement agreements, without additional regulations, governments will also be obligated to file information returns with the IRS. With billions of dollars of overpayments flowing to CMS each year, imposition of these additional hurdles will slow down the return of monies to CMS as providers will now have to negotiate for settlement agreements and CMS will be required to file tens of thousands of information returns with the IRS each year.

Thus, we strongly urge the IRS to issue regulations that address the scenario we have identified here: instances where there may be a technical violation of law, without an attendant fine or penalty, and the resolution of which does not typically result in a settlement agreement or court order.

To be clear, there are several avenues by which the IRS could accomplish this result. It could issue regulations that define a "violation of law" in a circumscribed manner and in a manner consistent with the body of case law that has developed regarding what constitutes a fine or penalty. It could define a "violation of law," as requiring more than just a mere technical violation of any law.

It could also issue regulations broadly defining "settlement agreement" to include instances where there is not a formalized agreement signed by both parties and includes correspondence to which the government impliedly assents. The drawback to this approach, however, is that it still imposes on the government the obligation to file information returns with the IRS ,regarding that agreement.

The exclusion of returns of overpayments originally received in good faith from the scope of a "violation of law" would thus be the most straightforward and most administratively simple approach and doing so would still remain consistent with the purpose of the provision.

III. Conclusion

We strongly urge that the IRS issue regulations that align the definitions of key section 162(f) terms with its long-established purpose of disallowing deductibility for those payments to the government that severely frustrate national policy and not as one that indiscriminately includes any and all payments made to the government for any violation of law.

Yours truly,

Jeffry J. Erney
Chair, Tax Controversy Group
Partner, Tax

C G Janney /adm
Chris G. Janney
Partner, Health Care & Life Sciences

Peter J. Anthony
Senior Managing Associate, Tax