



South Carolina Attorney General's Office: Consumer Protection in South Carolina and IRS Regulations Affecting Consumer Protection Settlements

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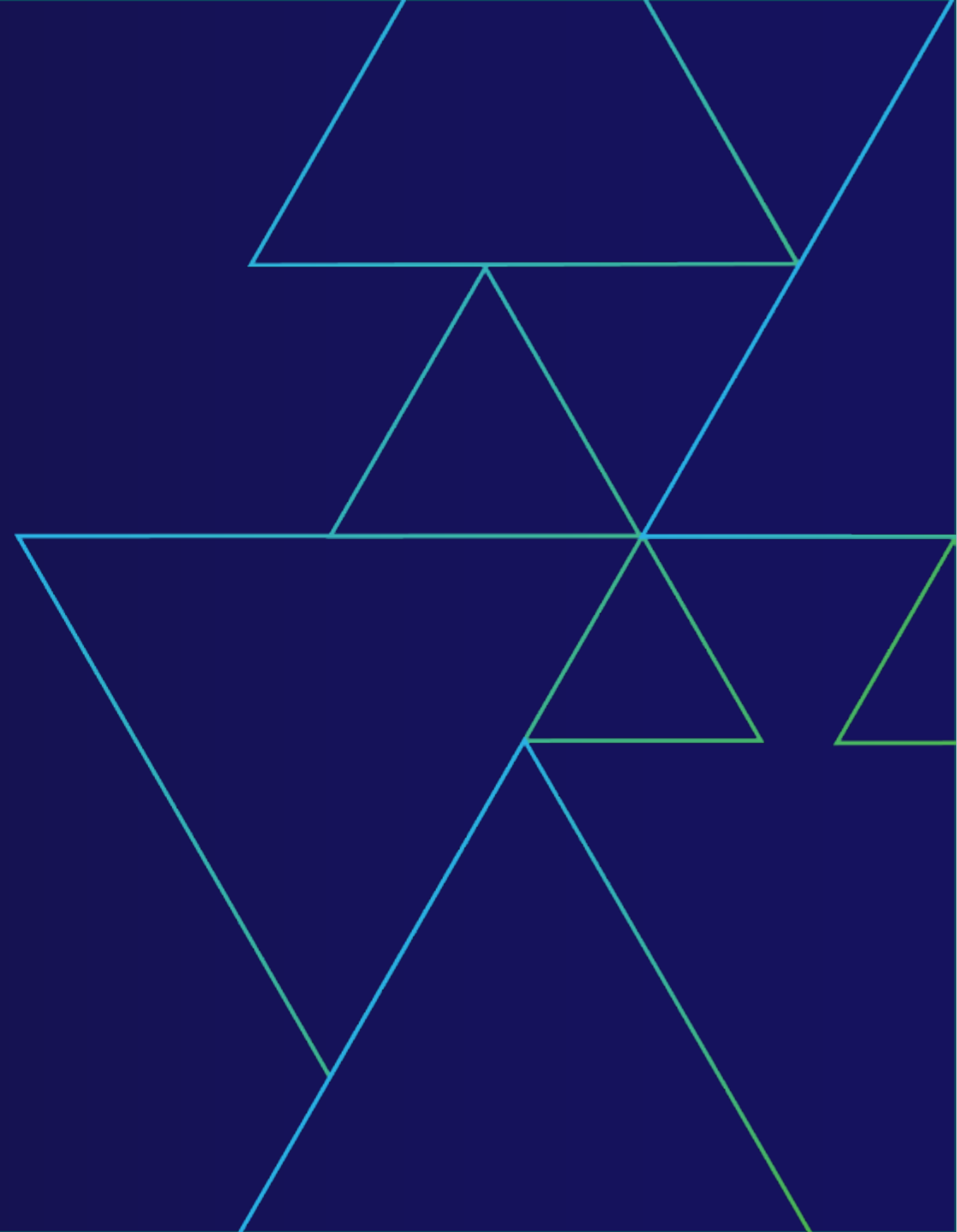


Agenda

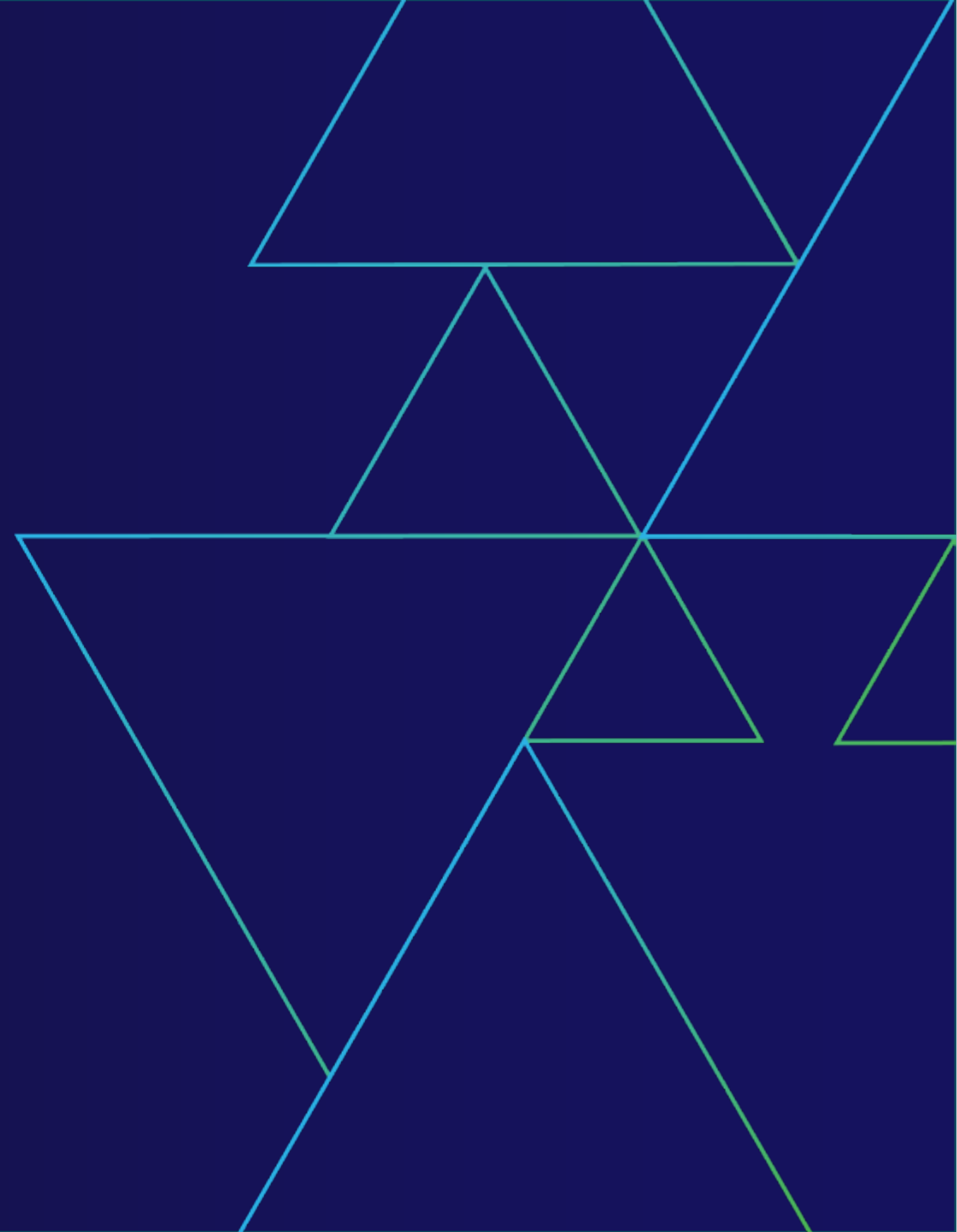
- Consumer Protection in South Carolina
- Consumer Protection Law Lightning Round
- IRS Regulations Affecting Consumer Protection Settlements

Consumer Protection in South Carolina

General Wilson



Consumer Protection Lightning Round



Consumer Protection Lightning Round: Background & Policy

- How is the AG selected in your state?
- How is consumer protection organized in your office?
- How are consumer protection priorities set in your office?
- Do you participate in multistate consumer investigations?
- Do you receive consumer complaints?
- Do you perform any complaint resolution role?

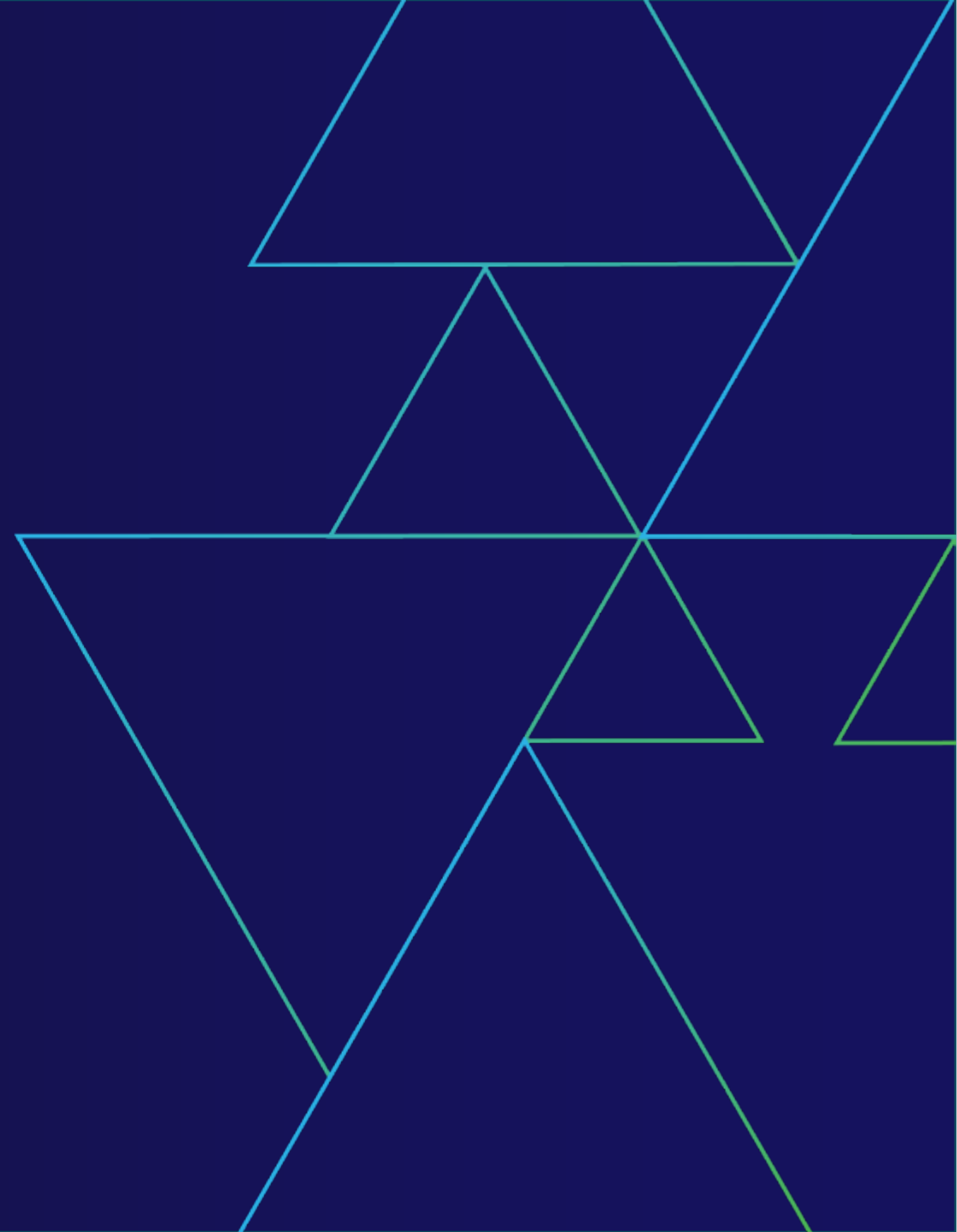
Consumer Protection Lightning Round: State-Specific UDAP Law

- What is your primary consumer protection statute?
- Are you able to conduct pre-suit investigations by statute?
- Can you request documents? Take statements? Send interrogatories?
- Are CIDs confidential? Are answers confidential?
- Does your law allow a party to object or set aside? If so, in what timeframe?
- How can you enforce compliance?
- Do you have a statute of limitations? If so, what is it?
- Do you have to provide pre-suit notice? If so, what timeframe?

Consumer Protection Lightning Round: Remedies & Other Laws

- What types of settlements can you enter into?
- What is your civil penalty authority?
- Can you obtain restitution? Disgorgement?
- Are there times you don't get injunctive relief? Penalties/payment?
- How are IR terms enforced? What if they are in an AVC?
- Do you have specific laws and remedies for price gouging?
- Do you have specific laws and remedies for auto-renewals?
- Do you have a privacy law?
- Any new noteworthy CP laws recently introduced/passed?

IRS Regulations Affecting Consumer Protection Settlements



Disclaimer

- I am not speaking for anyone other than myself.
- I am not a tax lawyer.
- I am not your lawyer.
- I am DEFINITELY not your tax lawyer.

A Little History

- 26 U.S. Code § 162(f) was amended as part of the Tax Cuts and Jobs Act
 - Signed into law on December 22, 2017
 - IRS final regulations promulgated on January 24, 2021
- OLD RULE: “[N]o deduction shall be allowed . . . for any fine or similar penalty paid to a government for the violation of any law.”
- NEW RULE: “[N]o deduction otherwise allowable shall be 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.”

A Little History

- The purpose of this change was to impose further restrictions on what companies and individuals could claim as tax deductions in government enforcement cases.
- Previously, all money paid except for civil penalties could potentially be claimed as a deduction.
- Under the new rule, no money can be claimed as a deduction unless it falls within a statutory exception.

A Little History

- The rule does not apply where the taxpayer **establishes** that the money is:
 - Restitution (including remediation of property) for damage or harm which was or may be caused by the violation of any law or the potential violation of any law, or
 - Paid to come into compliance with any law which was violated or otherwise involved in the investigation or inquiry.
- The money is **identified** in the court order or settlement agreement as restitution, remediation, or as an amount paid to come into compliance with the law.
- Establishment does not meet the identification requirement and identification does not meet the establishment requirement. See 26 C.F.R. § 1.162-21(b)(2)(ii); (b)(3)(i).

A Little History

- The exception to the rule does not apply “to any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.” 26 U.S.C. § 162(f)(2)(B).
- “Regardless of whether the order or agreement identifies them as such, restitution, remediation, and amounts paid to come into compliance with a law do not include any amount paid or incurred—[a]s reimbursement to a government or governmental entity for investigation costs or litigation costs incurred in such government or governmental entity’s investigation into, or litigation concerning, the violation or potential violation of any law[.] 26 C.F.R. § 1.162-21(e)(4)(iii).
- This includes attorneys’ fees for both state and private counsel.

Applicability of the Rule

- The rule applies broadly to matters involving **governmental entities**:
 - Federal, state, district, territorial, or foreign governments;
 - Attorneys' General offices;
 - State agencies and political subdivisions;
 - Federal, county, municipal, territorial and tribal entities;
 - Corporations serving as an instrumentality of the government; and
 - Nongovernmental entities which exercise self-regulatory powers, such as enforcing rules and imposing sanctions, as part of performing an essential government function.
 - But not nongovernmental entities of U.S. Territories, foreign governments, or tribes.
- The rule applies broadly to **enforcement actions**:
 - Consumer protection, antitrust, securities, environmental, Medicaid fraud, criminal matters, code violations, etc.

Applicability of the Rule

- The rule applies regardless of whether a lawsuit is filed.
- The rule applies regardless of whether a defendant/investigatory target admits to any misconduct.
- The rule applies regardless of whether the money is paid directly to the governmental entity or at its direction.
 - This includes payments for agencies and consumers (whether directly or through a restitution fund), as well as costs of an independent monitor.
 - Unclaimed restitution funds may be deposited into a State's general fund without impacting tax treatment.
 - However, if unclaimed funds are returned to the settling company, they must be treated as income.

Inapplicability of the Rule

- The rule does NOT apply when the governmental entity is enforcing its rights as a private party, such as in a breach of contract action. See 26 C.F.R. § 1.162-21(c)(1).
- The rule does NOT apply to payments made to a governmental entity by court order in a case where no governmental entity is a party.
- The rule does NOT apply to routine investigations or audits, if conducted to ensure compliance rather than in response to suspected wrongdoing. See 26 C.F.R. § 1.162-21(a)(3)(ii).

Restitution

- Restitution is defined as money “paid or incurred to restore, in whole or in part, the person . . . ; government; governmental entity; property; environment; wildlife; or natural resources harmed, injured, or damaged by the violation or potential violation of any law . . . to the same or substantially similar position or condition as existed prior to such harm, injury or damage.” 26 C.F.R. § 1.162-21(e)(4)(i).
- Includes both civil and criminal restitution.

Restitution

- Restitution may include amounts paid or incurred as disgorgement or forfeiture, so long as:
 - The disgorgement/forfeiture amount cannot be in excess of the net profits earned.
 - The disgorgement/forfeiture amount cannot be disbursed to the governmental entity for general enforcement or other discretionary purposes.
- See 26 C.F.R. § 1.162-21(e)(4)(i)(B).

Remediation

- Remediation in the context of environmental matters requires a “strong nexus” between the purpose of the payment and the environmental harm caused. See 26 C.F.R. 1.162-21(e)(4)(i)(A)(4).
- Remediation includes amounts paid or incurred for the purpose of:
 - Conserving soil, air, or water resources;
 - Protecting or restoring the environment or an ecosystem;
 - Improving forests; or
 - Providing a habitat for fish wildlife, or plants.
- Remediation may be paid either directly to the governmental entity or to a segregated account or fund.

Costs of Compliance

- Compliance costs are defined as money “paid or incurred to come into compliance with a law that the taxpayer has violated, or is alleged to have violated, by performing services; taking action, such as modifying equipment; providing property; or doing any combination thereof to come into compliance with that law.” See 26 C.F.R. § 1.162-21(e)(4)(ii).
- In consumer protection/antitrust matters, compliance costs will take the form of costs needed to effectuate certain kinds of injunctive relief in a settlement agreement.
- Compliance costs may take the form of direct payments (either to the states or as directed by them) or internal expenditures.

Costs of Compliance

- **KEY PRINCIPLE:** there must be a connection between the expense and the laws alleged to be violated. The measure is compliance with the law, not compliance with a settlement agreement.
 - Correcting misleading advertising statements, replacing a defective product, or implementing a “know your customer” program are examples of likely valid compliance costs.
 - Creating a document repository, conducting employee trainings, or lost revenue from foregone product sales as part of a UDAP settlement are likely not compliance costs.
 - Even costs such as retaining an independent monitor, hiring a compliance officer, or preparing compliance reports for the states are more appropriately treated as costs to comply with a settlement rather than the law.

Costs of Compliance

- A company may upgrade to a higher standard or go beyond what is required by the law. This extra money is not deductible under §162(f) but may be deductible under other sections of the Tax Code.
- Governmental entities are not required to verify the accuracy of compliance costs.
- Not all injunctive terms are likely designed to bring a company into compliance with the law (some may be intended to measure compliance or to help ensure a company remains in compliance), but both sides will need to be on the same page regarding which terms fall in which category.

Identification

- Any money a company wants to deduct must be identified as restitution, remediation, or costs of compliance in the court order or settlement agreement resolving the matter.
 - Magic words are not required as long as the effect of the language in the document is clear and unambiguous.
- If a payment is described appropriately but an exact amount is not listed, or a lump-sum payment is described appropriately but not allocated between categories, the identification requirement may still be met.
 - The order or agreement must “describe[] the damage done, harm suffered, or manner of noncompliance with a law, and describe[] the action required of the taxpayer, such as paying or incurring costs to provide services or to provide property.” 26 C.F.R. § 1.162-21(b)(2)(iii).

Establishment

- To obtain a deduction, the company must establish, through documentary evidence:
 1. The company had a legal obligation to pay the restitution, remediation, or costs of compliance.
 2. The amount paid or incurred.
 3. The date the amount was paid or incurred.
 4. The amount paid or incurred was for restitution, remediation, or costs of compliance.
- If the money is paid to a segregated fund, the establish requirement may be met even if each ultimate recipient or use of the money is not designated or unknown.

Establishment

- Documentary evidence needed to meet the establishment requirement includes, but is not limited to:
 - Receipts;
 - Laws or regulations related to violations or potential violations;
 - Documents issued by the governmental entity relating to the investigation;
 - Court pleadings filed by the governmental entity requesting restitution, remediation, or action to come into compliance with the law;
 - Documents describing how the amount to be paid was determined;
 - Correspondence between the company and governmental entity.
- However, the 1098-F form CANNOT be used to satisfy the establishment requirement (or the identification requirement).

Reporting Requirements

- 26 U.S. Code § 6050X requires the appropriate official of a governmental entity to file an information return with the IRS in the event of a settlement or judgment.
 - Purpose is to verify that companies and individuals are accurately reporting their tax deductions.
 - The appropriate official can be either the person with control over the case, or another designated person such as someone in administration or the finance department.
- Applies to orders or settlements which became binding on or after January 1, 2022, regardless of appeal status.

Reporting Requirements

- IRS Form 1098-F – Fines, Penalties, and Other Amounts must be filed:

0303 VOID CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Total amount required to be paid \$	OMB No. 1545-2284 Form 1098-F (Rev. January 2022)	Fines, Penalties, and Other Amounts
		2 Amount to be paid for violation or potential violation \$		
		3 Restitution/remediation amount \$		
FILER'S TIN	PAYER'S TIN	4 Compliance amount \$	5 Date of order/agreement For calendar year 20 ____	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the current General Instructions for Certain Information Returns.
PAYER'S name		6 Court or entity		
Street address (including apt. no.)		7 Case number		
City or town, state or province, country, and ZIP or foreign postal code		8 Case name or names of parties to suit, order, or agreement		
(Redacted area)		9 Code		

Form **1098-F** (Rev. 1-2022) Cat. No. 71382B www.irs.gov/Form1098F Department of the Treasury - Internal Revenue Service
Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

- <https://www.irs.gov/pub/irs-pdf/i1098f.pdf>

Reporting Requirements

- Only applies to settlements or judgments which exceed \$50,000.
 - If the amount is indeterminate or contingent, the reporting requirement is triggered only if the governmental entity reasonably expects that the amount paid will exceed \$50,000.
- If multiple payments are required, those payments should be aggregated in order to determine whether reporting is required.
- A written statement must be furnished to the taxpayer by January 31 of the year following the settlement or judgment.
 - Most likely this will be a copy of the completed 1098-F form.
- Forms are due to the IRS by February 28 (paper) or March 31 (electronic) of the year following the settlement or judgment.

Reporting Requirements

- The reporting obligation only arises for entities which have a payment obligation.
 - If multiple corporate entities settle, but only one assumes the payment obligation, Form 1098-F is filed only for that particular entity.
 - The governmental entity will need proper taxpayer information, including TIN.
- Even if payments occur over several years, only one form needs to be filed for a particular matter.

Reporting Requirements

- If settling with multiple states, one state may be designated to submit the form to the IRS, so long as each state is a party to a common settlement agreement and there is uniformity on how the states are using the funds.
 - However, if each state enters into its own settlement, or states are using the funds for various purposes, separate 1098-F forms for each state may be necessary.
 - Separate 1098-F forms can also be challenging where a company seeks a deduction for common injunctive terms, as these would need to be allocated across each settlement.

Practical Considerations

- Ensure the settlement language is consistent with the state's reporting obligations.
 - If the state has costs (and the state typically always has costs) or outside counsel, the state cannot agree that all of the funds are restitution, remediation, or compliance costs.
- While unknown or unidentified payments may still be sufficient to meet the identification requirement in some cases, the establishment requirement cannot be met without demonstrating actual payments for approved purposes.
- Do not expect states to agree to vague, poorly defined, or unreasonable terms or amounts regarding compliance costs. Remember the necessary link between the expenditure and the laws alleged to be violated.

Practical Considerations

- Remember that 1098-F forms, like settlement agreements, are likely public documents subject to the state's open records law.
- The company's legal fees and expenses in defending against an investigation or enforcement action are not amounts paid or incurred to a governmental entity and are thus beyond the scope of §162(f).
- Interest (both prejudgment and postjudgment) is treated identically (for deductibility purposes) as the type of payment which generates the interest.
- The rules of §162(f) apply regardless of whether the governmental entity properly provides a written statement and files the 1098-F form.

Thank you



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