

## 'It's Deductible': Must It Be?

To the Editor:

Robert W. Wood's careful examination (*Tax Notes*, Sept. 18, 2006, p. 1053) of the tax deduction issues surrounding the Boeing settlement focuses attention on two very important questions. First, he explores the extent to which Justice Department attorneys considered tax consequences while negotiating the settlement. Second, he analyzes the question of whether the Boeing settlement payment is deductible.

Mr. Wood directs attention to a Government Accountability Office study finding "that four large federal agencies (including the Justice Department) do not negotiate with companies over whether settlement payments are tax deductible." The GAO claims that the agencies consider that issue to be "the IRS's job." The citation for the GAO statement is an *Id.* cite to Wayne, "3 Senators Protest Possible Tax Deduction for Boeing in Settling US Case," *The New York Times*, July 7, 2006, p. C3. While researching this question for a related purpose, as I'll explain in the next paragraph, I discovered that some of the other companies that have reached settlements with the government regarding other types of disputes have accepted provisions in the settlement agreement under which they promise not to deduct the payments. I discovered that information in the same GAO report that makes the assertion concerning the four large federal agencies that do not negotiate the deductibility of the settlement payments. Strangely, I found the information in the very same paragraph of the GAO report:

Other than some settlements with civil penalties containing language stating that the penalties are not deductible, the settlement agreements we reviewed generally did not specify the deductibility of settlement amounts, which was consistent with what the agency officials told us. As an example of the exceptions, we found that some DOJ environmental settlements with civil penalties did include language in the agreement between DOJ and the settling company that the penalties would not be deducted for federal income tax purposes. DOJ officials said that including such language is not standard practice and emphasized that since the law is generally clear that civil penalties paid to a government are not deductible, stating so in the settlement agreement is merely restating the law.

See Government Accountability Office, Report to the Committee on Finance, U.S. Senate, "Tax Administration: Systematic Information Sharing Would Help IRS Determine the Deductibility of Civil Settlement Payments 21 (Sept. 2005), <http://www.gao.gov/new.items/d05747.pdf> (visited July 31, 2006). The confusion that Mr. Wood describes is in part a consequence of how the GAO

presented its findings in the report and during media inquiries following the Boeing settlement news.

The question that has my attention at the moment is a third one, whether Boeing may ignore the deduction if, as it asserts, a portion of the settlement payment is deductible. The question of whether deductions are mandatory in all instances, or are mandatory only under certain circumstances, is addressed in my article, "No Thanks, Uncle Sam, You Can Keep Your Tax Break," 31(1) *Seton Hall Legislative Journal* (forthcoming), currently available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=929119#PaperDownload](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=929119#PaperDownload). When the news of the Boeing settlement appeared this summer while I was working on the article, it required me to add to the list of why taxpayers might choose to ignore a deduction, namely, public relations goals, as Mr. Wood carefully explains in his article. If the position taken by the "all deductions are mandatory" advocates — a group to which I do not belong — is correct, Boeing must claim the deduction to the extent any portion of the settlement payment is deductible. Of course, the lack of standing on the part of any person, other than the IRS or Boeing, to raise the issue, and the determination by Boeing not to claim the deduction, illustrates one of the several practical reasons that I am not an "all deductions are mandatory" advocate.

The confusion surrounding the deductibility of settlement and other payments, and the uncertainties in the minds of many tax practitioners regarding the mandatory nature of deductions, simply add to the constantly growing list of reasons why Congress needs to buckle down and reform the tax law in a meaningful way. So long as Mr. Wood and others continue to share with the tax world, and the public generally, the glitches and snags of the tax law's complexity, the less likely it is that the demand for tax reform can be muted.

Jim Maule  
Professor of Law  
Villanova University School  
of Law  
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