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No Tax Write-Offs for Wall Street Wrongdoing

Imagine enjoying a tax windfall for breaking the law or squandering someone else's money. Unfortunately, on Wall Street some financial institutions have acted with willful disregard for the public and the economy – and then have been able to write off part of the cost of their misdeeds on their taxes.

It is time the federal government stopped letting corporate wrongdoers add insult to injury by passing off the costs of their misconduct to taxpayers.

Misleading Mortgage Guarantors at Citigroup

Citigroup made millions of questionable mortgages between 2000 and 2012, and, according to officials at Fannie Mae, made misrepresentations that led the federal mortgage guarantor to back them. When the financial crisis hit in 2008 and millions of these mortgages went bad, Fannie Mae was on the hook for billions of dollars in home loans it would never have knowingly guaranteed.[1]

The sudden and unexpected explosion in Fannie Mae's liabilities threatened the future of the entire U.S. housing market and forced the federal government to step in, committing hundreds of billions of tax dollars to keep both Fannie Mae and the broader housing market on their feet.[2] In the summer of 2013, Citigroup settled Fannie Mae's charges of misrepresentation with a financial settlement of almost $968 million, though analysts reported that Citigroup could deduct this from its taxes, potentially leading to a $339 million savings for the corporation.[3]

Rigging Interest Rates at UBS

According to federal regulators, traders at UBS allegedly spent the years between 2005 and 2010 attempting to rig the key international interest rate known as "Libor," a global benchmark that influences more than $300 *trillion* in global financial transactions.[4] Even small adjustments in the rate were potentially worth many millions to UBS but could harm U.S. consumers left on the losing side of artificially altered borrowing costs and undermined growth in municipal pension funds.[5] In 2008, half of U.S. adjustable rate mortgages were pegged to Libor, as were about half of student loans.[6] Cities and counties from Maryland to California have claimed losses to their pension funds caused by Libor manipulation.[7]

To settle charges surrounding its involvement in the scandal, UBS agreed to a three-country, $1.5-billion financial payment, $1.2 billion of which went to U.S. agencies.[8] As media coverage at the time noted, UBS could potentially deduct much of the settlement from its taxes, which would leave everyday taxpayers to pick up the tab for the financial giant's illegal market manipulation.[9]

JPMorgan Chase's "London Whale" Fiasco

According to federal officials, in the first quarter of 2012, JPMorgan Chase engaged in high-risk "proprietary trading" – buying and selling investments for the bank's own accounts rather than for clients – led by a chief trader nicknamed "the London whale." The bank's London office ultimately lost more than $6 billion in trading and then attempted to keep bank regulators in the dark about the losses.[10] Similar high-risk betting contributed to the global financial meltdown of 2008, which led to enormous taxpayer bailouts of banks deemed "too big to fail." In September 2013, JPMorgan Chase admitted wrongdoing and paid $920 million to regulators in two countries, including $700 million to the U.S. Securities and Exchange Commission (SEC), Federal Reserve Board and Office of the Comptroller of the Currency.[11] Though the SEC included language specifying the tax consequences of its portion of the settlement worth $200 million, the deductibility of the other $500 million paid to American regulators was not addressed, making it possible for JPMorgan Chase to write off the remainder as a tax deduction.[12]

Abetting a Ponzi Scheme at TD Bank

In 2008 and 2009, Canada-based TD Bank and one of its former regional vice presidents allegedly abetted a $1.2 billion Ponzi scheme by producing misleading documentation and lying to investors in the scheme about accounts held by the scheme's operator, who is now serving a 50-year prison term. The former regional vice president allegedly made false assurances that TD Bank had restricted the transfer of funds in the schemer's accounts even as suspicious activity continued, leaving the investors vulnerable to the billion-dollar scam.[13] The scale of the individual losses was significant. For example, 40 of the swindled investors are seeking to recover a combined total of $19 million, an average of $475,000 each.[14]

In September 2013, TD Bank cut a deal worth $53 million with the Financial Crimes Enforcement Network, the Office of the Comptroller of the Currency and the Securities and Exchange Commission to resolve the charges that it had violated the law. The settlement agreement failed to prohibit the bank from deducting the settlement from its taxes, making it possible to write it off as a deduction.[15]

When Wall Street Does Wrong, the Public Often Picks Up the Tab

Citigroup, UBS, JPMorgan Chase and TD Bank allegedly engaged in illegal behavior that ripped off consumers and investors and jeopardized the health of the financial system. Yet, rather than paying the full price of their misdeeds, federal law opens the door for companies that agree to settlements with government regulators to take a tax deduction for all or part of the cost of the payout.

How can this happen? Though corporations cannot legally write off public penalties or fines as tax breaks, companies whose lawyers cut a deal to avoid trial *may* be able to write off payments made to settle allegations of wrongdoing by treating such payments as an ordinary and necessary business expense.[16] They can do so because government agencies often fail to define a settlement's deductibility in the formal agreement.[17] This ambiguity, clouded further by complicated case law, creates a **settlement loophole** corporations can take advantage of to secure a discount on their payouts.[18] The IRS states that "almost every defendant/taxpayer deducts the entire amount" of their financial settlement with the government as a business expense.[19] According to a 2005 Government Accountability Office study of 34 companies' settlements worth more than $1 billion, 20 companies deducted some or all of their payments.[20]

Experts believe that Citigroup and UBS could find a way to dodge some of the financial hit in their settlements.[21] And neither JPMorgan Chase nor TD Bank entered into settlement agreements that prohibited them from deducting the cost of their payouts on their taxes, leaving the door open for these banks to hand much of the bill for their misdeeds to everyday taxpayers.

Every dollar in tax savings companies enjoy this way must ultimately be paid for by ordinary Americans in the form of program cuts, increased federal debt, or higher taxes to make up the difference.

Stop Subsidizing Wall Street Wrongdoing

Taxpayers should not be forced to subsidize corporations that violate rules designed to protect the public from financial chicanery, environmental damage, fraud or the selling of a dangerous product.

The federal government should require all settlement agreements to clearly define their tax consequences and to communicate that information clearly to the corporation, the IRS and the broader public. In addition, government agencies should:

- Make all settlement payouts non-deductible by default, including standard language in all agreements to that effect. The Environmental Protection Agency often does this and the Securities and Exchange Commission increasingly does the same.[22]
- Publicly disclose all settlements on agency websites and include information about any portion that corporations have not been barred from deducting on their taxes.
- Require corporate filings to the Securities and Exchange Commission to explain whether any settlement payments were written off.
- Ensure "truth in advertising" by requiring regulators and corporations to disclose the *after-tax* amounts of settlements, a more accurate portrayal of the penalty a company will really pay.

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Notes

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