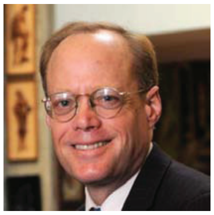

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THE TAX LAWYER

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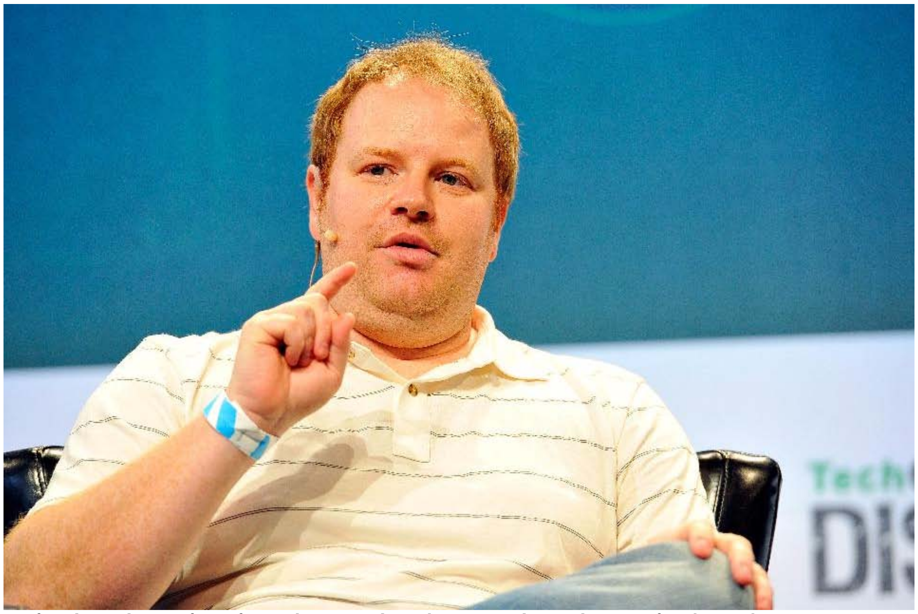
Can Zenefits Write Off $7 Million Fine?

Zenefits has been fined $7 million by California's insurance regulator. In a press release, California Insurance Commissioner Dave Jones said that Zenefits was charged with allowing unlicensed employees to sell insurance and circumventing education requirements for insurance agents. Zenefits makes human-resources software that helps HR professionals manage health benefits, payroll, etc. In addition to the $7 million fine, Zenefits must pay California $160,000 toward the costs of its investigation. There may be other fines coming, but this is a big one, one of the largest penalties for licensing violations ever assessed.

Zenefits offers free software to businesses and makes money acting as a health insurance broker. The California Department of Insurance launched an investigation in 2015 after receiving complaints that Zenefits employees were transacting insurance without a license. Multiple states launched investigations into the company's practices. Zenefits will not have to pay the full $7 million to California up front. In recognition of changes at Zenefits, half of the fine will be waived if the company passes an exam of the company's business practices scheduled for 2018.



Co-founder and CEO of Zenefits Parker Conrad speaks onstage during day one of TechCrunch Disrupt SF 2015 on September 21, 2015 in San Francisco, California. (Photo by Steve Jennings/Getty Images for TechCrunch)

So can Zenefits write-off the fines it is paying? In general, fines and penalties paid to the government are not deductible. Section 162(f) of the tax code prohibits deducting ''any fine or similar penalty paid to a government for the violation of any law.'' You might think that this tax code section resolves the point. Yet despite punitive sounding names, some fines and penalties are considered remedial and deductible. That allows some flexibility, provided that the actual settlement documents do not expressly say that something is a non-deductible fine.

Companies often deduct 'compensatory penalties,' a maneuver affirmed in a recent Circuit Court ruling. Some defendants insist that their settlement agreement confirms that the payments are not penalties and are remedial. Conversely, some government entities insist on the reverse. Explicit provisions about taxes in settlement agreements are becoming more common. But barring express non-deductibility commitments, many penalties can be deducted, too.

For example, the Department of Justice did expressly forbid Credit Suisse from deducting its $2.6 billion settlement for helping Americans evade taxes. Ditto for the BNPP terror settlement, which states that BNPP will not claim a tax deduction. Sometimes the government and a defendant split the baby. Of the $13 billion JP Morgan settlement struck in late 2013, only $2 billion was said to be nondeductible. The DOJ doesn't always disclose the terms of settlements either.

But that could change. The proposed Truth in Settlements Act (S. 1898 – fact sheet) would require agencies to report after-tax settlement values. Another bill, S. 1654, would restrict tax deductibility and require agencies to spell out the tax status of settlements. The U.S. Public Interest Research Group tracks the tax implications of legal settlements, and they are not easy on the DOJ, saying that the DOJ should forbid deductibility. A poll released by the U.S. Public Interest Research Group Education Fund says most people disapprove of deductible settlements. U.S. PIRG has also created a fact sheet on Wall Street settlement tax deductions.

For alerts to future tax articles, email me at Wood@WoodLLP.com. *This discussion is not legal advice.*

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