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Charlie Sheen's \$10M Blackmail Tax Deduction

Charlie Sheen said he was diagnosed as HIV positive four years ago. Since then, he has paid \$10 million in extortion money to keep the information quiet. Sheen told [NBC's "Today" show](#) he was speaking out now because he was being blackmailed. He also wants to refute tabloid reports that he has AIDS and was spreading it to others.

For years, Sheen played a womanizing bachelor on "Two and A Half Men," earning a reported \$1.8 million per episode. But he spent big and was eventually fired for bad conduct. His earnings since may have dipped, but has paid a lot. There's probably a nicer name for it, but blackmail is a term sometimes ascribed to many types of legal settlements.



Actor Charlie Sheen appears during an interview, Tuesday, Nov. 17, 2015 on NBC's "Today" in New York. In the interview, the 50-year-old Sheen said he tested positive four years ago for the virus that causes AIDS. (Peter Kramer/NBC via AP)

Lawsuits are by their nature adverse, and most legal settlements in a business or investment context are tax deductible. It's just one of the [10 things you should know about taxes on legal settlements](#). Many taxpayers try to find a business connection to most any legal mess. Whether they succeed depends on the facts and what motivated the payment. It is not unrealistic to think the Charlie Sheen and his adviser are thinking taxes.

One barrier is for fines or penalties paid to the government. [Section 162\(f\)](#) of the tax code prohibits deducting "any fine or similar penalty paid to a government for the violation of any law." That includes criminal and civil penalties as well as sums paid to settle potential liability for a fine. Another no-no is deducting bribes and illegal payments. This too is often debated, for taxpayers have a big incentive to try to deduct payments. And reputation-preserving payments that keep a business or profession alive can sometimes be deducted.

Sometimes, tax deductions land the person in court again. In [SEC v. Bilzerian](#), Mr. Bilzerian paid off his stockbroker and tried to deduct it, even though Bilzerian was convicted of violating securities laws and conspiring to defraud the IRS. That didn't necessarily mean the payoff to his stockbroker was itself illegal, he argued. Bilzerian created entities to hide his ownership of stock, and when his broker lost money and found out, Bilzerian paid the broker \$125,000 to make up for the broker's loss. Bilzerian deducted it as a business expense.

Later, Bilzerian was convicted of violating securities laws, making false statements and criminal conspiracy. The IRS disallowed his tax deduction saying the related \$125,000 payment had to be illegal. The IRS claimed the payment was nondeductible regardless of whether the payment itself was legal since it was made in furtherance of an illegal activity. The Tax Court ruled that only payments illegal by themselves were nondeductible.

The recent problems of [former House Speaker Dennis Hastert](#) prompted new discussions over the reporting dangers of cash. Assuming that he [was extorted, Mr. Hastert can probably deduct his losses](#). Even a payment in cash without a receipt can sometimes generate a tax deduction. In fact, one [tax receipts rule IRS keeps quiet is that they're optional](#).

Consider John Edwards' legal fees in his criminal trial. Although it was a criminal trial, the charges related to his conduct in his chosen trade or

business: politics. That arguably should make the legal fees [deductible](#). What about deducting payments to Rielle Hunter to keep her quiet? Edwards didn't *personally* pay her, and the apparent source of funds was donations. The trial was about *who* paid her, with what funds, and whether Mr. Edwards was *personally* aware of it.

Still, hush money—even blackmail—has probably been claimed on more tax returns than you might think. Bribes and illegal payments are nondeductible, but it's often not so clear exactly what something is. As [Bill Clinton said, it depends on what the meaning of the word "is" is](#).

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