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THE TAX LAWYER

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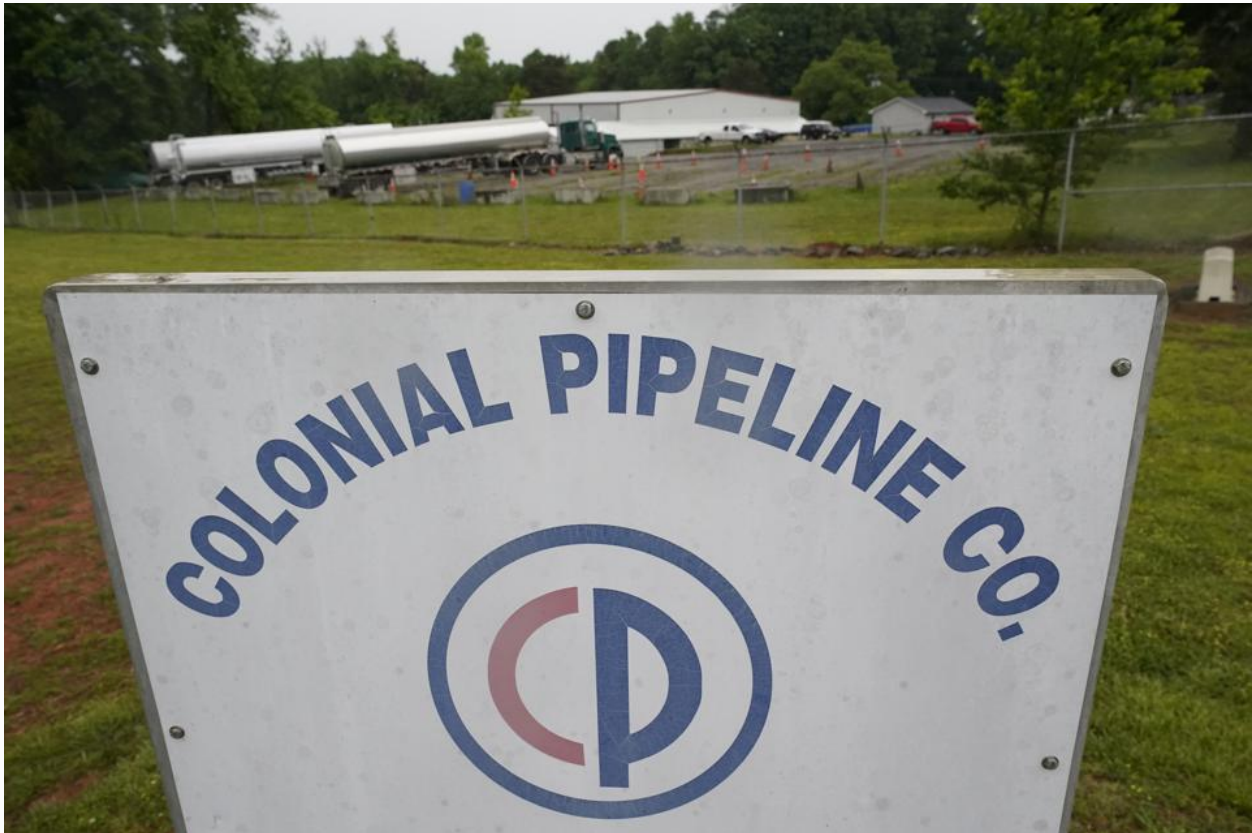
Colonial Pipeline Paid \$4.4 Million In Bitcoin Ransom. Is It Tax Deductible?

On May 19, Colonial acknowledged that it paid \$4.4 million worth of bitcoin to the hackers. Well, with bitcoin's drop, the value might be less now, but the key to taxes is what the value was at the time of payment. In the case of some hacks, the cost of being frozen out is just too big.

If you pay hackers ransom to keep your business operating, is it tax deductible? The taking of money or property through fraud or misrepresentation is theft if it is illegal under state or local law. For businesses, paying ransom or blackmail is likely to fall into the wide category of business expenses. For example, most [legal settlements and legal fees](#) in business are tax deductible, even ones that are unusual. Consumers face a much tougher time.

Even when receiving money, some plaintiffs cannot deduct their legal fees, so must pay taxes on 100% of a recovery even with a contingent fee lawyer. Plaintiffs may need to be creative to find [ways to deduct legal fees](#). But in

business, even blackmail can be claimed. [The IRS defines](#) theft as the taking and removing of money or property with the intent to deprive the owner of it. The taking of property must be illegal under the laws of the state where it occurred, and it must have been done with criminal intent. Hacking for ransom should surely fit the bill. Besides, to claim a deduction, you do not need to show a conviction for theft. Theft is pretty broad too, including the taking of money or property by Blackmail, Burglary, Embezzlement, Extortion, Kidnapping for ransom, Larceny and Robbery. Expenses must be [ordinary, necessary and reasonable](#) to be deductible, but that doesn't take much.



An expense is “ordinary” even if it is once in a lifetime. Necessary is also easy. Even a payment in cash without a receipt can sometimes generate a tax deduction. Sure, the [IRS wants tax receipts, but sometimes they are optional](#). Hush money—even blackmail—has probably been claimed on more tax returns

than you might think. However, bribes and illegal payments are nondeductible. So are many fines or penalties paid to the government. Even so, there can be grey areas. When it comes to fines and penalties paid to the government, the prohibition is in [Section 162\(f\)](#) of the tax code. It 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. The rule for bribes and illegal payments is also often debated. Taxpayers have big incentives to try to deduct such payments if they can. It can take some creative arguments. 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. 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. However, the Tax Court ruled that only payments illegal by themselves were nondeductible.

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