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If You Pay Ransom, Write It Off On Your Taxes

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If you pay hackers ransom to keep your business operating, is it tax deductible? Whether personal or business, it probably is, although the type of deduction can vary. [The IRS defines](#) a 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. But to claim a deduction, you don't need to show a conviction for theft. Theft includes the taking of money or property by:

- Blackmail.
- Burglary.
- Embezzlement.
- Extortion.
- Kidnapping for ransom.
- Larceny.
- Robbery.

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. In fact, many taxpayers try to find a business connection to virtually any legal mess. Most [legal settlements](#) in business are tax deductible, even ones that are unusual, such as [Charlie Sheen's \\$10 million blackmail](#). Even that could be deductible.

The same is usually true for big legal fees, even though in some sense they seem unreasonable. [Martha Stewart](#) paid huge legal fees on an obstruction of justice charge from the sale of Imclone stock. To pay legal fees, she sold 75,000 shares of Martha Stewart Living stock (raising \$4.67 million). SEC filings

revealed she sought reimbursement (as an officer and director) for \$3.7 million of fees for her successful defense on the charge that she tried to lift her own company's share price by declaring that she was innocent of insider trading.

The granddaddy celebrity legal fiasco was Michael Jackson's molestation trial. His acquittal on child molestation charges came at a price. Some estimates put the King of Pop's legal expenses at \$20 million. I don't know if he deducted them, but ironically, Dr. Murray, convicted in connection with his death, could probably deduct his fees as a business expense even though he was convicted. Whether facing a civil malpractice trial or a criminal trial, his legal expenses relate to his trade or business. He was treating Michael Jackson and being paid for it.

Technically 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. In fact, [tax receipts are sometimes optional](#). John Edwards faced a criminal trial related to his conduct in his chosen trade or business: politics. That could make it all tax [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. Hush money—even blackmail—has probably been claimed on more tax returns than you might think. Bribes and illegal payments are nondeductible, but as [Bill Clinton said, it depends on what the meaning of the word "is" is](#). 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. 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. The Tax Court ruled that only payments illegal by themselves were nondeductible. Although [former House Speaker Dennis Hastert](#) faced criminal charges over his handling of his own cash when he [was extorted, Mr. Hastert could probably deduct his losses](#).

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