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If You Pay Cyberattack Ransom, Deduct It On Your Taxes

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Yet again, there has been a major cyber attack, this time on a very large scale. This time, the [massive cyberattack was traced to tax software](#). It is said to have impacted people in 64 countries, with its origins in a Ukrainian company's tax accounting software. Reports say impacted systems are offered the chance to get files released for a simple payment of \$300 in bitcoin. You might think the haul for the hackers would be huge, but evidently it was not. Still, there were clearly some people who paid, whatever the government and tech advisers were suggesting. It is understandable, since the cost of being frozen out can just be too big. So 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 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. Remember [Charlie Sheen's \\$10 million blackmail](#)? Even that might be tax deductible.

[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
- Robbery

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](#).

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. As [Bill Clinton said, it depends on what the meaning of the word "is" is](#). 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.

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