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Fox $787 Million Dominion Settlement Tax Write Off Is No Surprise

The $787 million settlement by Fox[FOXA -1.4%] News and Fox Corporation to resolve the Dominion defamation suit made big news, but the tax news that this is a deductible business expense to Fox should be no surprise. It appeared that Fox was likely to lose the defamation suit, and likely would have had to pay much more in a verdict. That made the settlement a good business move. Some sources are expressing shock that this kind of liability could be a legitimate business expense.

Compensatory settlements by businesses are clearly deductible if they arise out of the business being conducted. Fox clearly meets that test. It doesn't matter if the conduct producing the expense is later viewed as wrongful. The only exception is for certain confidential settlements in sexual harassment cases. In fact, even *punitive* damages are tax deductible when paid by businesses. Tax bills have been introduced in Congress over the years to change that, but the bills never gained traction. Sometimes, even amounts paid to the government are deductible, despite corporate wrongdoing.

For decades, Section 162(f) of the tax code prohibited 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. This sounds absolute, but the law is riddled with exceptions. To begin with, the rules cover only government payments, and some companies find ways to write off even the biggest payments.

For example, BP probably wrote off a majority of its $20.8 billion out-of-court settlement for the Gulf Oil spill. The deal designated only about one quarter, $5.5 billion, as a non-tax-deductible Clean Water Act penalty. Congress has pushed back on such practices. In 2017, the tax rules were tightened by the Trump tax reform law. But even under the new rules, it is permissible to write off certain payments of restitution or amounts paid to come into compliance with law.

A poll released by the U.S. PIRG Education Fund says most people disapprove of deductible settlements. U.S. PIRG has also created a fact sheet on Wall

Street settlement tax deductions. Some settlement agreements contain an explicit no-deduction provision. For example, when Tesla[TSLA +0.9%TSLA +0.9%] and Elon Musk settled with the SEC for $20 million each, a court filing said Tesla expressly agreed not to claim a tax deduction for its $20 million. Had it not been for that agreement, the tax write-offs don't seem to have been prohibited. After all, the SEC said the $40 million in penalties will be distributed to harmed investors under a court-approved process, and that sounds like restitution.

The strange tax treatment of legal settlements impacts plaintiffs too in a big way. All punitive damages are taxable ordinary income, even for death or serious injury. That is why even Roundup Weedkiller cancer victims can face IRS taxes when they sue. The IRS even taxes fire victims. Even worse, there is a tax on litigation settlements, in some cases, as many legal fees can't be deducted. Plaintiffs may pay tax even on monies their attorney collects, even though the attorney must *also* pay tax on the same money.

If you are a plaintiff with a contingent fee lawyer, the IRS treats you as receiving 100% of the money, even if the defendant pays your lawyer *directly*. Plaintiffs have to get creative to deduct their legal fees under a 2018 tax law just to get back to even. How compensatory damages are taxed to plaintiffs is tough too. Dominion clearly has taxable income on it settlement. And many individual plaintiffs are taxed on whatever they receive in lawsuit settlements.

Since 1996, the tax code says your injury must be "physical" to be tax free. If you sue for intentional infliction of emotional distress, your recovery is taxed and even physical symptoms of emotional distress (like headaches and stomachaches) are taxed. The rules can make some tax cases chicken or egg, with many judgment calls. Many plaintiffs take aggressive positions on their tax returns, but that can be a losing battle if the defendant issues an IRS Form 1099 for the entire settlement. Haggling over tax details before you sign and settle is best.

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