Forbes

Robert W. Woodd

THE TAX LAWYER

TAXES 1/19/2016

Goldman Sachs' Historic $5 Billion Settlement Has Silver Lining: Tax Deduction

The reported agreement between Goldman Sachs and federal regulators is supposed to settle the bank's alleged misconduct in connection with the mortgage crisis. The proposed deal includes a $2.385 penalty, an $875 million cash payment, and $1.8 billion in consumer relief. At least the $2.675 billion is tax deductible, which means a $936.25 million rebate for the bank at taxpayers' expense.

Such tax deductible settlements are one reason for the proposed Truth in Settlements Act (S.1109). It would require federal agencies to disclose the tax deductibility of settlements. It would also require corporations to disclose deductible settlements. Most legal settlements in business are tax deductible. It's just one of the 10 things you should know about taxes on legal settlements.

Not everything is deductible. In fact, 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. But many companies can negotiate for smaller nondeductible fines and bigger deductible payments.

For example, BP should be able to write off a majority of its $20.8 billion out-of-court settlement related to the Gulf Oil spill. The deal designated only about one quarter, $5.5 billion, as a non-tax-deductible Clean Water Act penalty. One big critic of such deal is U.S. Public Interest Research Group, which often rails against tax deductions claimed by corporate wrongdoers. The organization has a research report here on settlement deductions. But the present tax code allows businesses to deduct damages, even punitive damages.

Restitution and other remedial payments are also fully deductible. Only certain fines or penalties are nondeductible. Even then, the rules are murky, and companies routinely deduct payments unless it is completely clear that they cannot.

Some lawmakers and consumer advocates say that the Justice Department and federal regulators need to take taxes into account in striking settlement deals, and even in touting settlement figures in announcements. Otherwise, people think it’s costing a targeted business one thing, when the after tax cost —paid for by taxpayers—is something else. Given our media sensitive culture, it is a fair point.

Explicit provisions about taxes in settlement agreements are becoming more common. For example, the DOJ did expressly forbid Credit Suisse from deducting its $2.6 billion settlement for helping Americans evade taxes. Ditto for the BNPP terror settlement, which states that BNPP will not claim a tax deduction. Sometimes the government and a defendant split the baby.

Of the $13 billion JP Morgan settlement struck in late 2013, only $2 billion was said to be nondeductible. The DOJ doesn't always disclose the terms of settlements either. But that could change. A poll released by the U.S. PIRG Education Fund says most people disapprove of deductible settlements. BP might fuel such sentiments.

In the meantime, it should be no surprise that companies often deduct 'compensatory penalties.' The maneuver was recently affirmed in a Circuit Court ruling. U.S. PIRG has also created a fact sheet on Wall Street settlement tax deductions. In addition to fines and penalties, bribes and illegal payments are nondeductible. Even so, it is 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 legal advice.