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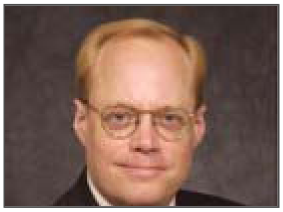

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Hastert Pleads Not Guilty, But Can Write Off Blackmail On His Taxes

The news that former House Speaker Dennis Hastert was indicted over cash payments has prompted new discussions over the risks and IRS reporting dangers of handling cash. There has even been talk about hush money and blackmail. Surprisingly, the hush money is probably tax deductible as a loss, or perhaps as a necessary business expense to Dennis Hastert's business reputation.

Of course, Mr. Hastert will need to prove he paid it, but the charges he faces could help him do that. Even a payment in cash without a receipt can sometimes generate a tax deduction. In fact, one tax receipts rule IRS keeps quiet is that they're optional. Assuming that he was extorted, Mr. Hastert can probably deduct his losses.

Many taxpayers try to find a business connection to most any legal problem. Whether they'll succeed depends on the facts, and what motivated the payment. One big no-no relates to fines or penalties paid to the government. The tax code prohibits deducting "any fine or similar penalty paid to a government for the violation of any law."

Former House Speaker Dennis Hastert arrives at the federal courthouse, Tuesday, June 9, 2015, in Chicago for his arraignment on federal charges that he broke federal banking laws and lied about the money when questioned by the FBI. The indictment two weeks ago alleged Hastert agreed to pay $3.5 million to someone from his days as a high school teacher not to reveal a secret about past misconduct. (AP Photo/Paul Beaty)

That includes criminal and civil penalties as well as sums paid to settle potential liability for a fine. Another no-no: deducting bribes and illegal payments. This is often debated, for taxpayers have a big incentive to try to deduct payments. But in *SEC v. Bilzerian*, Mr. Bilzerian paid off his stockbroker and deducted it, even though Bilzerian was convicted of violating securities laws and conspiring to defraud the IRS.

That didn't necessarily mean the payoff to his stockbroker was itself illegal, Bilzerian argued. 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, and his disguised ownership scam was one of the counts.

The IRS disallowed his tax deduction saying the related $125,000 payment had to be illegal. Bilzerian fought the IRS arguing he just made good on the broker's loss. 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 the IRS is cracking down on government settlements, the flow is steady. As Bilzerian proved, sometimes persistence and creativity in tax disputes can pay off. Consider John Edwards' legal fees in his criminal trial. Although it was a criminal trial, the charges related to his conduct in his chosen trade or business: politics. That arguably should make the legal fees 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. Still, if someone in Mr. Edwards' position paid hush money (let's assume not from campaign sources, but from his own pocket), would it be deductible?

The answer depends on the facts and how Edwards positioned himself, but it is not out of the question. In fact, hush money–even blackmail–has probably been claimed on more tax returns than you might think. Bribes and illegal payments are nondeductible, but it's often not so clear exactly what something is. After all, as Bill Clinton said, it depends on what the meaning of the word "is" is.

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