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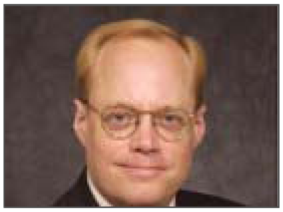

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THE TAX LAWYER

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How Come HSBC's $550 Million Housing Settlement Actually Costs Taxpayers $192 Million?

HSBC is paying the Federal Housing Finance Agency (FHFA) $550 million in a settlement. Here's the full text of the settlement agreement and the press release. The settlement resolves claims that HSBC violated federal and state securities laws in its representation of mortgage-backed securities that contributed to the 2008 financial crisis.

That's good, but who is paying for this? HSBC, of course, but if HSBC can write off the settlement? That's where the rest of us come in. If you do the math, a tax write-off by the bank could shift something like $192.5 million onto taxpayers. Whether the write-off is legit can be debated, but the FHFA did not state expressly that the settlement payment cannot be deducted as a business expense.

HSBC arguably did some slick negotiating. One group critical of the FHFA is the U.S. Public Interest Research Group. The settlement saves HSBC from going to trial on September 29, a trial in which HSBC could have faced up to $1.6 billion in damages. That together with the tax point makes it look like a pretty good deal.

Not long ago the FHFA also settled with Goldman Sachs. As here, there was no prohibition on tax deductions. Some lawmakers and consumer advocates say the government needs to take taxes into account in the settlement figures. Otherwise, people think it's costing a targeted business one thing, when the after tax cost—paid for by taxpayers—is something else.

Not everything in business is deductible. In general, fines and penalties paid to the government are not deductible. The U.S. Public Interest Research Group tracks the tax implications of legal settlements. That group is not easy on the DOJ, saying the DOJ should forbid deductibility.

Section 162(f) of the tax code prohibits deducting ''any fine or similar penalty paid to a government for the violation of any law.'' Yet despite punitive sounding names, some fines and penalties are considered remedial and deductible. That allows some flexibility. As a result, some defendants insist that their settlement agreement confirms that the payments are not penalties and are remedial instead.

Explicit provisions about taxes in settlement agreements are becoming more common. For example, the feds 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.

An example was the $13 billion JP Morgan settlement struck in late 2013. Of that only $2 billion was said to be nondeductible. The DOJ doesn't always disclose the terms of settlements either. But that could change.

The proposed Truth in Settlements Act S.1898 (fact sheet) would require agencies to report after-tax settlement values. This proposed legislation and its counterpart in the House (H.R.2434), would require federal agencies to disclose the tax deductibility of settlements. Corporations would also be required to disclose when they deducted those settlements.

Where those bills will go remains to be seen. U.S. PIRG has also created a fact sheet on Wall Street settlement tax deductions. And a poll released by the U.S. Public Interest Research Group Education Fund says most people disapprove of deductible settlements.

Maybe, but there is currently nothing illegal about companies maneuvering to deduct ‘compensatory penalties. In fact, a recent Circuit Court ruling supports the practice.

Contact me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.