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How 'Painful' Is PG&E's \$2.25B Fine For San Bruno Pipeline Explosion? \$900M Tax Savings

On September 9, 2010, a horrific pipeline explosion and fire destroyed a neighborhood in San Bruno, California. The conflagration “took the lives of eight citizens of our city, destroyed 38 homes, and left a hole in the heart of San Bruno,” said Mayor Jim Ruane. Understandably, the City of San Bruno wants PG&E to pay.



San Bruno Fire (Photo credit: zennie62)

The California Public Utilities Commission (CPUC) has been struggling with how PG&E should be penalized. Although the deal is not set, one big issue is what credit the utility should receive for past costs and repairs. Plus, a tax deduction is proving to be a new flashpoint. See [CPUC Filing by City of San Bruno Calls for PG&E to Pay Maximum Penalty without Credits for San Bruno Blast and Fire](#).

PG&E could evidently deduct 100% of the proposed \$2.25 billion penalty on its taxes. That rubs some people the wrong way. What's more, credits and perks could tally many past expenditures. Tax deductibility is seen by some as making the deal even worse.

In fact, senior attorneys in the CPUC's safety division went so far as to call the proposed penalty deal "unlawful." The final penalty is now mired in controversy. Some say the end result could be that PG&E's effectively pays almost nothing.

But San Bruno now is asking for total penalties of \$3.8 billion—or \$2.45 billion in after-tax dollars. San Bruno also wants a series of remedial measures. For many tax deductions are surprising, though they probably should not be.

After all, most payments in business are deductible, even punitive damages. See [Can Rolls-Royce Deduct Bribes? How About Fines?](#) It's true that the tax code prohibits deducting "any fine or similar penalty paid to a government for the violation of any law." See [IRC Section 162\(f\)](#). That includes criminal and civil penalties, yet many companies are able to deduct fine-like settlements.

The line-drawing can be extreme. If a fine or penalty is intended to be punitive, it is probably nondeductible. But if the fine is remedial in nature, it may be deductible despite its "fine or penalty" name. Environmental payments and other payments to governmental entities may qualify.

Example: Suppose you pay a \$100 million fine. If it's nondeductible, it costs \$100 million. But if you are in a 40% tax bracket and can deduct it, the fine actually costs you \$60 million after taxes.

Some find this troubling from a policy standpoint. Remember Exxon's \$1.1 billion Alaska oil spill settlement? It actually cost Exxon \$524 million after taxes. See [BP, Oil, and Deducting Punitive Damages](#). More than half of the \$900 million in civil damages Exxon paid were also deductible.

It is sometimes possible to settle with a government agency and to address this issue. The settlement agreement may specify that a fine is remedial rather than punitive in character. If the settlement agreement isn't specific—and sometimes even if it is—tax deductions may land companies in court a second time. See [Tax Deductions for Damage Payments: What, Me Worry?](#)

There is often considerable ambiguity, which can encourage taxpayers to claim deductions. See [IRS Cracking Down on Government Settlements](#). Compensatory damages are clearly deductible. So are punitive damages paid in the course of a trade or business. Thus, deductions are likely despite the fact that tax deductions for wrongdoers rub many the wrong way.

A good example is BP's large payments relating to the Gulf oil spill. Last year, Sen. Bill Nelson, D-Fla., called for a congressional inquiry into BP's tax treatment. Interestingly, Senator Nelson didn't focus solely on the extent to which BP would deduct fines, penalties or related counsel fees.

He also asked whether BP should be allowed to deduct the \$20 billion placed in escrow for injured parties. He even questioned the tax treatment of the compensatory damages paid to federal and state governments. In fact, whether the wrongdoer is BP or PG&E, the public is becoming increasingly watchful for tax breaks that it perceives help to ameliorate—or might even be seen to encourage—bad behavior. See [PG&E's \\$900 million San Bruno tax break?](#)

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