



Robert W. Wood

THE TAX LAWYER

TAXES | 10/22/2013

JP Morgan Chase's \$13B Settlement -- And Whale-Sized Tax Deduction

At [JPMorgan Chase](#), you want record earnings and deals, not record settlement payments. But the nation's biggest bank with \$2.4 trillion in assets could be days away from the biggest and most painful settlement ever. As big as the \$13 billion number is, it may not preclude criminal prosecution. What's more, it could involve an express admission of wrongdoing, something that could curtail tax deductions and fuel shareholder suits.

JPMorgan Chase already paid more than \$1 billion to resolve U.S. and U.K. queries into its whale trades. But those numbers pale now. Among the difficult mechanics are the numerous agencies involved. But even the \$13 billion is less controversial than a possible admission of guilt.

A non-prosecution agreement has been floated but seems unlikely. An acknowledgement of wrongdoing is becoming more standard from the SEC and others. Admissions of guilt would tarnish the bank's public image and foment shareholder litigation.



JPMorgan Chase & Co Chairman and CEO Jamie Dimon testifies before the House Financial Services Committee on Capitol Hill June 19, 2012 in Washington, DC. After testifying before the Senate last week, Dimon answered questions from the committee about his company's \$2B trading loss earlier this year. (Image credit: Getty Images via @daylife)

The \$13 billion deal under discussion would resolve a suit [by the regulator](#) of Fannie Mae and Freddie Mac and [another](#) by New York's Attorney General. Civil charges by the Justice Department are pending but not yet filed. \$9 billion of the \$13 billion would apparently be called fines but would help partially repay taxpayers for the \$188 billion bailout of Fannie Mae and Freddie Mac.

The other \$4 billion, even more expressly remedial, would help homeowners struggling with their mortgages. And remediation (as opposed to payments to ***punish***) should mean tax deductions. Paying nondeductible fines and penalties is doubly painful.

Despite their punitive sounding names, some fines and penalties are viewed as remedial (and thus deductible) rather than penal in nature. For that reason, defendants want a settlement agreement to confirm that payments are not penalties and are remedial. Tax language in settlement agreements doesn't bind the IRS, but it goes a long way toward avoiding tax disputes.

The U.S. Public Interest Research Group thinks precluding JPMorgan Chase from claiming tax deductions should be explicit to safeguard taxpayers. The group claims that unless JPMorgan Chase is explicitly forbidden, it will write off the settlement. That would make taxpayers bear 35% of the cost of the settlement.

Can JPMorgan Chase find a way to deduct the \$13 billion in the absence of an express prohibition? It depends, but the nature and scope of any admissions of fault may be pivotal. At the same time, some admissions may allow deductions, even for some fines or penalties.

The tax code prohibits deducting "any fine or similar penalty paid to a government for the violation of any law," including criminal and civil penalties plus sums paid to settle potential liability for fines. See [IRC Section 162\(f\)](#). In reality, many companies deduct settlements, even those that are quasi-fine-like in character. Exxon's \$1.1 billion Alaska oil spill settlement cost Exxon \$524 million after tax. More recently, BP's Gulf spill raised similar issues. See [BP, Oil, and Deducting Punitive Damages](#).

In determining what is a nondeductible fine or penalty, names alone are not controlling. If the fine or penalty is intended to be ***punitive***, then the payment is probably nondeductible. But if it is ***remedial***, it may be deductible ***despite*** a "fine or penalty" label.

It is sometimes even possible to settle with a government agency and explicitly address taxes in the settlement agreement, specifying that any “fine” is actually remedial rather than punitive in character. But the government often won’t agree, as occurred in [*Fresenius Medical Care Holdings Inc. v. United States*](#). Fresenius (a medical device company) resolved claims for criminal and civil health care fraud.

It paid a criminal fine of \$101 million and a civil settlement of \$385 million. The company deducted the payments, but the IRS claimed they were non-deductible penalties. The IRS said the only way Fresenius could deduct the payments would be if the settlement agreement expressly allowed it. Yet the government had refused to address taxes in the underlying agreement.

JPMorgan Chase is facing bigger issues than taxes. Still, given the large dollars at stake, the bank may well be able to negotiate for tax deduction language or at least for language that doesn’t preclude it.

You can reach 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.