



Robert W. Wood

THE TAX LAWYER

Oct. 15 2012

McLaren Gets €40m Fine For Swiping Ferrari Designs, But Hey, It's Tax Deductible

McLaren was in the soup after a dossier of documents relating to the design and workings of a Ferrari turned up in the possession of their (then) Chief Designer Mike Coughlan. Oops. That ended up triggering a [€40m fine](#). When you pay something like that, it smarts. Of course, it smarts a lot less if you deduct it on your taxes.



McLaren M8D Can-Am racing car at Mathews Collection, Arvada, Colo., USA. (Photo credit: Wikipedia)

McLaren argued the “fine” was not a statutory penalty but one incurred under [Formula One](#) rules and therefore a business expense. Her Majesty’s Revenue and Customs ([HMRC](#)) disagreed but a tax tribunal ruled for McLaren.

The Judge said: “This cost was not one imposed on McLaren, but one which it was contractually obliged to pay under contractual obligations undertaken for the purposes of its trade.” That’s a business expense. Would U.S. businesses do this? You bet.

Example: If you pay a \$100 million fine you can deduct and are in a combined 40% state and federal tax bracket the fine only costs you \$60 million after tax.

The general rule is that payments in a business context are deductible. That's even true with punitive damages you are ordered to pay. However, 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 as well as sums paid to settle potential liability for a fine. Even so, many individuals and companies alike end up able to deduct settlements that are at least quasi-fine-like in character. And there are huge dollars at stake.

Example: Exxon's \$1.1 billion Alaska oil spill settlement actually cost Exxon \$524 million after tax. See [BP, Oil, and Deducting Punitive Damages](#).

What's a nondeductible fine or penalty? Don't go by names alone. First, you only have to worry about payments to a governmental entity. Surprisingly, punitive damages paid to private parties are fully deductible. But even some fines or penalties paid to the government can be deductible.

If the fine or penalty is intended to be ***punitive***, then the payment is probably nondeductible. But if it is instead ***remedial*** in nature, then it may be deductible ***despite its "fine or penalty" name***.

Environmental payments and a variety of payments to governments and quasi-governmental entities are routinely questioned in this way.

It is sometimes even possible to settle with a government agency and actually cover this issue in the settlement agreement, specifying that any "fine" is actually remedial rather than punitive in character.

McLaren had other problems too, including being excluded from the 2007 constructors' championship. Plus, their fine was originally a record \$100 million (which then equated to €82m), but then was then cut by about €42m of television and travel money the team lost as a result of their expulsion. It's the new math, and taxes nearly always play a part.

*Robert W. Wood practices law with [Wood LLP](#), in San Francisco. The author of more than 30 books, including *Taxation of Damage Awards & Settlement Payments* (4th Ed. 2009 with 2012 Supplement, [Tax Institute](#)), he can be reached 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.*