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# No Tax Deduction For Toyota's \$1.2 Billion 'What Sudden Acceleration?' Settlement

The Department of Justice [announced](#) a record [\\$1.2 billion settlement](#) with Toyota in a criminal probe of its handling of sudden acceleration complaints. The criminal charge claims Toyota defrauded consumers via misleading safety statements. Toyota Motor Corp's deal is a record in several ways.

First, it resolves a record criminal probe of an automaker. It is the largest financial penalty of its kind ever imposed on an auto company, said Attorney General Eric Holder. Second, the dollars are big. Toyota will pay a record \$1.2 billion to settle the criminal probe. Third, Toyota *admitted* that it misled consumers about two problems that caused cars to accelerate while drivers were trying to do the reverse.



(Photo credit: Wikipedia)

Finally, [Toyota Agreed to Forego Tax Deduction for \\$1.2 Billion Settlement With DOJ](#). Deducting the settlement would have made taxpayers bear 35% of the cost. Toyota's road has been tortured. It initially denied that it knew about a defect causing sudden acceleration. However, an FBI investigation revealed internal company documents that discussed the problems.

Under a [deferred prosecution agreement](#), an independent monitor will review Toyota's policies, practices and procedures. Moreover, it says "Toyota agrees that it will not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state, local, or foreign tax for any fine or forfeiture paid pursuant to this Agreement." Tax deductions for business expenses are normal, since our system taxes net income, not gross.

But some deductions rub some people the wrong way, and this one is worth \$420 million. Toyota posted a \$5.2 billion profit in its last quarter alone, according to the [AP](#). A legal settlement can often be deducted unless it is paid to the government and penal in nature. But since standards are fuzzy, companies often find a way to deduct some of all of the settlement.

In Toyota's case, the DOJ pushed to make it clear that the company would not claim a deduction. Other recent examples of such prohibitions involved Steve Cohen's SAC Capital and JP Morgan Chase. But whether settlement non-deductibility should be explicit has become controversial.

The IRS has [found](#) that unless agencies specifically prohibit it, companies typically deduct entire settlements. A 2005 GAO [report](#) recommended that agencies institute clear rules around the tax treatment of settlements. The Truth in Settlements Act (S. 1898 – [fact sheet](#)) was introduced in January. A separate bill that would restrict write offs on settlements (S. 1654) was introduced in November and has a House counterpart (HR 3445).

U.S. PIRG's research report, "[Subsidizing Bad Behavior: How Corporate Legal Settlements for Harming the Public Become Lucrative Tax Write-Offs.](#)" contains a [fact sheet](#) on settlement deductions, plus fact sheets on settlement in [Wall Street scandals](#), [consumer rip offs](#), and [health care](#) scams.

Tax language in settlement agreements doesn't bind the IRS, but it goes a long way toward avoiding tax disputes. Explicit provisions about taxes may become more common. At the very least, explicit provisions impact an important financial term and avoid confusion.

After all, despite punitive sounding names, some fines and penalties are viewed as remedial rather than penal in nature. That would make them deductible. That is precisely why some defendants insist that their settlement agreement confirms that the payments are not penalties and are remedial. Toyota presumably couldn't do that here. Indeed, the shoe was on the other foot with DOJ's insistence on no-deduction language.

General Motors may find itself in a similar position, as it is clearly next in line. GM is being investigated over how it handled an ignition switch failure linked to a numerous deaths. GM last month recalled more than 1.6 million vehicles 13 years after first noticing the issue. Whenever that is resolved, it might look like a Toyota knockoff.

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