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PG&E Gets $470 Million Tax Deduction For Fire Settlements

As bankrupt utility PG&E settles its fire liabilities, are taxes involved? You bet. A new regulatory filing says that PG&E's $1.68 billion settlement agreement with California over wildfires could save the utility $470 million in taxes. Nearly all the wildfire recovery and prevention work included in the agreement should be deductible from both its state and federal taxes, PG&E said. The agreement covers Northern California's 2017 and 2018 fires. Although tax deductions might rub consumers the wrong way, it is hardly surprising that PG&E's $1.7 billion settlement could yield a tax break. Plainly, tax deductions make any legal settlement less painful, and they are standard fare for business. That's hardly a new concept, nor is uneasiness about some of the rules.

These are business expenses, after all, and that reduces taxable income. Yet in general, when plaintiffs recover money, it is taxed, and the IRS taxes fire victims too. In fact, how fire victims are taxed is a complex subject. Business expenses are less so. Worry about tax deductions runs deep. Way back in 1961, President John F. Kennedy said, "The slogan — 'It's deductible' — should pass from our scene." President Kennedy made the comment about expense accounts and business entertainment, but it has broader application and still seems timely more than half a century later. Compensatory settlements by businesses are clearly deductible, yet when it comes to corporate wrongdoing, emotions on this issue can run high. You might think the tax law would prevent this, but that's not so clear. For decades, Section 162(f) of the tax code has prohibited deducting any fine or similar penalty paid to a government for the violation of any law. That includes criminal and civil penalties, as well as sums paid to settle potential liability for a fine.

This sounds absolute, but the law is riddled with exceptions. To begin with, the rules cover only government payments, and creative companies can often find ways to write off even the biggest payments. After all, many fines are not made to punish, but to fund some kind of remediation, and that can make a difference. For example, BP probably wrote off a majority of its $20.8 billion out-of-court settlement for the Gulf Oil spill. The deal designated only about one quarter, $5.5 billion, as a non-tax-deductible Clean Water Act penalty. Congress has pushed back on such practices. In 2017, the tax rules were tightened by the Trump tax reform law. Even under the new rules, however, it is still permissible to write off certain payments of restitution or amounts paid to come into compliance with law. Some settlement agreements contain an explicit no-deduction provision. For example, the Department of Justice expressly blocked Credit Suisse from deducting its $2.6 billion settlement for helping Americans evade taxes. The same was true of the BNPP terror settlement, which states that BNPP will not claim a tax deduction.

But various government agencies have seemed reluctant to develop or enforce policies, so it seems to be a hit or miss affair. One big critic of deductible settlements is U.S. Public Interest Research Group, which often rails against tax deductions by corporate wrongdoers. U.S. PIRG has a research report, Settling For A Lack Of Accountability, that details the tax deductions corporations can claim for legal settlements. The group has asked the Justice Department to deny tax deductions for many corporate defendants. Arguably, companies are obligated to shareholders to be tax-efficient, and to claim deductions when they are entitled to them. And the tax law is frequently made up of shades of gray.

U.S PIRG has suggested that express prohibitions on deducting payments can sometimes be put in settlement agreements. Although proponents of such prohibitions, including Sen. Charles Grassley (R-Iowa), have talked about it for more than a decade, it seems hard to get it done. Some companies expressly agree not to deduct payments. For example, when Tesla and Elon Musk settled with the SEC for $20 million each, a court filing said Tesla expressly agreed not to claim a tax deduction for its $20 million. Had it not been for that agreement, the tax write-offs don't seem to have been prohibited. After all, the SEC said the $40 million in penalties will be distributed to harmed investors under a court-approved process. That sounds like restitution.

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