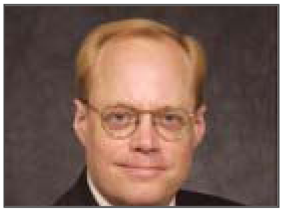

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SEC's $600M Slap To Steve Cohen's SAC Fund Not Bad After Taxes

Steve Cohen (Photo by Craig Barritt/Getty Images for The Robin Hood Foundation via @daylife).

The SEC announced Friday it settled—for a cool $600 million—insider trading charges with CR Intrinsic, an affiliate of billionaire Steve Cohen's hedge fund. See Steve Cohen's Hedge Fund To Pay Over $600M To Settle Insider Trading Charges. Trader Mathew Martoma still faces criminal charges over an alleged tip on clinical trial results for an Alzheimer's drug from Elan Pharmaceuticals. Sigma Capital Management (another Cohen affiliate) also settled for about $14 million insider trading related to Dell and Nvidia stock.

This is a win for the SEC with a big number, but a decided win for Cohen too. He and his funds admitted no wrongdoing and settled, and that probably means a cool tax deduction. The SEC charged CR Intrinsic with insider trading in November 2012. For more details, see SEC Complaint and Summaries of SEC Enforcement Actions Against Insider Trading.

Convicted hedge fund titan Raj Rajaratnam was ordered to pay a whopping $92.8 million penalty after his insider trading case. But that case involved a conviction and forfeitures involving Galleon Group. Mr. Rajaratnam was sentenced to 11 years in prison and will pay over $156 million. In fact, $92.8 million in civil penalties were heaped onto the already stiff criminal fines.

In the pantheon of big spenders, 1980s junk bond king Michael Milken paid $600 million in fines and restitution after he pled guilty to securities violations. Much of that was restitution—paid back to injured parties—which can be different from fines when it comes to taxes. But even fines can sometimes qualify for tax deductions so paying them is not as painful after all.

> **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.

Most payments in business are deductible, even punitive damages. 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. Huge dollars are 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 are deductible.

If the fine or penalty is intended to be ***punitive***, then the payment is probably nondeductible. But if it is ***remedial*** in nature, it may be deductible ***despite a "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. In light of these standards, how about SAC's $600 million? I don't know, but my guess would be that they can deduct most or even all of it.

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