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SEC Wants You To Admit Wrongdoing---And It Will Cost You

These days the SEC wants some defendants not merely to pay, but also to admit guilt. Admitting guilt in a civil case rubs many defendants the wrong way. Besides, it is an about-face from the SEC's longstanding practice of settling civil litigation ***without*** requiring the defendant to admit wrongdoing.

Exactly which cases will merit this special treatment will be determined case-by-case. But requiring admissions of guilt in stand-alone civil cases is a worry. Apart from public image issues, isn't private civil litigation (often from shareholders) a certainty after such an admission? It would seem so.

Tax deductions may be impacted too, since some fines and penalties cannot be deducted. That makes paying them all that much more painful. Defendants often want language in settlement agreements confirming that a payment is not a penalty and is remedial in nature. In *Fresenius Medical Care Holdings*

Inc. v. United States, the government made it clear that it would not agree to any tax characterization.

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 civil settlement payments on its taxes, which the IRS later disallowed. Suing for a tax refund, Fresenius said there was no penalty. After all, this was a civil settlement.

The settlement agreement included a stock provision saying that, "Nothing in this Agreement constitutes an agreement by the United States concerning the characterization of the amounts paid hereunder for tax purposes." Such provisions have become common at the insistence of the government. Yet in the later tax dispute, the government said the ***only*** way Fresenius could deduct the payment would be if the settlement agreement ***expressly*** allowed it.

Talk about a Catch-22! Sensibly, the court ruled that an advance agreement on deductibility is ***not*** necessary. Of course, whenever the settling parties can agree, they should. Indeed, the *Fresenius* court noted that a characterization agreed upon by the parties, and/or announced by a judicial officer, may well be ***determinative*** for tax purposes.

Tax language in settlement agreements may not bind the IRS, but it goes a long way to avoiding disputes. No one wants to be involved in a tax dispute. Companies concluding litigation want to pay the money, deduct it, and move on. And since there are always competing considerations in getting through a settlement, the government attitude displayed in *Fresenius* is chilling.

As it did in *Fresenius*, the government may refuse to include tax language in a settlement agreement, yet later claim the ***only*** way you can deduct the payment is with express language. You won't want to go to court to defend a tax deduction, but you may have to. In any case, you should keep supporting correspondence and documents.

After all, something short of an agreement in writing in the settlement agreement may prove to be very helpful. It never hurts to go overboard in gathering your non-penalty evidence. You have control over what correspondence you send, and you will know what you have received. Try to gather what you can whenever you can.

There may be other items that will surface, such as internal DOJ communications, correspondence between the DOJ and the IRS, or other inter- and intra-agency materials. You may not have seen all the ammunition that will be used against you in a later tax dispute. As a result, consider creating some self-serving documents of your own.

You may want to record impressions, observations, and facts contemporaneously with the settlement. Lawyers and company officials can be appropriate signatories for those items. It is done far less frequently than it should be.

To give them added gravitas (and perhaps even admissibility in court), consider having them signed under penalties of perjury. Consider all these items early as you are negotiating the settlement of the case. Documents prepared at tax return time—or even worse, at audit time—are never as persuasive.

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.*