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Tax Write-Offs For Government Settlements Could Be Restricted

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In general, fines and penalties paid to the government are not deductible. Section 162(f) of the tax code prohibits deducting ‘‘any fine or similar penalty paid to a government for the violation of any law.’’ You might think that this tax code section resolves the point. Yet despite punitive sounding names, some fines and penalties are considered remedial and deductible. That allows some flexibility, provided that the actual settlement documents do not expressly say that something is a non-deductible fine.

Companies often deduct ‘compensatory penalties,’ a maneuver affirmed in a Circuit Court ruling. Some defendants insist that their settlement agreement confirms that the payments are not penalties and are remedial. Conversely, some government entities insist on the reverse. Explicit provisions about taxes in settlement agreements are becoming more common. But barring express non-deductibility commitments, many penalties can be deducted, too.

British Petroleum, settling with the government for its role in the BP oil spill, earned a $15.3 billion tax write off for the deal. (Photo credit should read Andy Buchanan/AFP/Getty Images)

For example, the Department of Justice expressly blocked Credit Suisse from deducting its $2.6 billion settlement for helping Americans evade taxes. Same for the BNPP terror settlement, which states that BNPP will not claim a tax deduction. Sometimes the government and a defendant split the baby. Of the $13 billion JP Morgan settlement struck in late 2013, only $2 billion was said to be nondeductible. The DOJ doesn’t always disclose the terms of settlements either. But that could change.

Senators Elizabeth Warren (D-MA) and James Lankford (R-OK) have reintroduced the Truth in

Settlements Act. It would increase transparency for settlements between federal agencies and corporations accused of wrongdoing. When federal agencies announce settlement agreements, they regularly tout the top-line dollar value made to resolve allegations of misconduct. However, the public value of these settlements is diminished when corporations are allowed to receive massive tax write-offs and credits from these payments. Many times, these agreements are deemed confidential and details are hidden from the American public.

This legislation would require detailed and publicly accessible disclosures of these settlement agreements and the tax write-offs that accompany them. In September 2015, the bill passed unanimously through the Senate. "Republicans and Democrats agree that the transparency of our government agencies is vital to ensuring public trust, a robust democracy, and fair settlement deals," said Michelle Surka, advocate with U.S. Public Interest Research Group. "When government agencies strike settlement deals on behalf of the American public, we deserve to know the details."

In recent years, some of the largest settlements between corporations and federal government agencies included significant tax deductions for the corporation. British Petroleum, settling with the government for its role in the BP oil spill, earned a $15.3 billion tax write off for the deal. Though the tax code does state that fines and other penalties are not tax deductible, a consistent lack of specificity in settlement agreements has allowed companies to claim deductions nevertheless.

"Government accountability requires transparency, and that's what this bipartisan bill provides," Senator Warren said. "The Truth in Settlements Act will shut down backroom deal-making by shining a light on federal agency settlements with lawbreaking companies. More transparency means Congress, citizens and watchdog groups can better hold regulatory agencies accountable for enforcing laws so that everyone — even corporate CEOs — are equal under the law." U.S. PIRG has a research report on the tax implications of legal settlements here.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.