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THE TAX LAWYER

Mar. 7 2012 — 1:02 am

Unusual Tax Deductions? How About Blackmail?

There's probably a nicer name for it, but blackmail is a term sometimes ascribed to legal settlements. That's evidently what [Media Matters'](#) David Brock called a \$850,000 payoff to his former domestic partner. See [Media Matters Boss Paid Former Partner \\$850k 'Blackmail' Settlement](#). What's more, the payoff was allegedly to prevent his paramour from turning over damaging information involving donors and the IRS.



Lawsuits are by their nature adverse, some more than others. Mr. Brock accused William Grey of threatening to expose him and demanding “blackmail” that forced Brock to sell his home. The suit was settled.

If Mr. Brock wanted to, could he deduct the payment on his taxes? Many taxpayers try to find a business connection to most any legal mess. Whether they'll succeed depends on the facts and what motivated the payment. See [Tax Deductions for Damage Payments: What, Me Worry?](#)

One big no-no relates to fines or penalties paid to the government. The tax code prohibits deducting “any fine or similar penalty paid to a government for the violation of any law.” See [Section 162\(f\)](#). That

includes criminal and civil penalties as well as sums paid to settle potential liability for a fine. See [BP, Oil, and Deducting Punitive Damages](#).

Another no-no: deducting bribes and illegal payments. This too is often debated, for taxpayers have a big incentive to try to deduct payments. See [Cleaning Up: Tax Deductions for Restitution, Fines, and Penalties](#). Sometimes deductions land them in court again. Take [SEC v. Bilzerian](#), for example.

Mr. Bilzerian paid off his stockbroker and tried to deduct it, even though Bilzerian was convicted of violating securities laws and conspiring to defraud the IRS. That didn't *necessarily* mean the payoff to his stockbroker was *itself* illegal, he argued. Bilzerian created entities to hide his ownership of stock, and when his broker lost money and found out, Bilzerian paid the broker \$125,000 to make up for the broker's loss. Bilzerian deducted it as a business expense.

Later, Bilzerian was convicted of violating securities laws, making false statements and criminal conspiracy, and his disguised ownership scam was one of the counts. The IRS disallowed his tax deduction saying the related \$125,000 payment had to be illegal. Bilzerian fought the IRS arguing he just made good on the broker's loss.

The IRS claimed the payment was nondeductible regardless of whether the payment *itself* was legal since it was made in furtherance of an illegal activity. The Tax Court ruled that only payments illegal by *themselves* were nondeductible. See [IRS Cracking Down on Government Settlements – 11/2007](#). The IRS also argued that the payment was an essential part of his conspiracy conviction so was illegal.

However, the Tax Court said the payment was only one factor and that the legality of the payment was not even raised in the criminal trial. That meant Bilzerian got his deduction. Sometimes persistence and creativity in tax disputes can pay off.

For more, see:

[The Only Good Legal Fees Are Tax Deductible Legal Fees](#)

[BP, Oil, And Deducting Punitive Damages](#)

[Denying Deductions Based On Public Policy](#)

[Why Punitive Damages Should Remain Deductible](#)

[Tax Bill Prevents Employers From Deducting Punitive Damages](#)

[Tax Deductions For Damage Payments: What, Me Worry?](#)

[Rajaratnam \\$92.8M Penalty Highlights Tax Deduction Rules](#)

[IRS Audit Guide On Damage Awards Misses The Mark](#)

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