Reed-Grassley Introduce Bill to Prevent Corporate Penalties from Becoming Tax Write Offs

Feb 09, 2015

WASHINGTON, DC – In an effort to protect taxpayers, hold corporate wrongdoers accountable, and deter future fraud and abuse, U.S. Senators Jack Reed (D-RI) and Chuck Grassley (R-IA) are introducing bipartisan legislation to rescind tax write-offs for illegal corporate behavior. The Government Settlement Transparency & Reform Act would close a loophole that has allowed some corporations to reap tax benefits from payments made at government direction stemming from settling misdeeds.

Corporations accused of illegal activity routinely settle legal disputes with the government out of court because it allows both the company and the government to avoid the time, expense, and uncertainty of going to trial.

Federal law prohibits companies from deducting public fines and penalties from their taxable income. But under current law, companies may often write off any portion of a settlement that is not paid directly to the government as a penalty or fine for violation of the law. This allows some companies to lower their tax bill by claiming settlement payments to non-federal entities as tax deductible business expenses.

The Reed-Grassley bill would require the government and the settling party to reach pre-filing agreements on how the settlement payments should be treated for tax purposes. The bill clarifies the rules about what settlement payments are punitive and therefore non-deductible and increases transparency by requiring the government to file a return at the time of settlement to accurately reflect the tax treatment of the amounts that will be paid by the offending party.

“Preying on consumers or defrauding investors shouldn’t be classified as a business expense. If a company is paying thousands, millions, or even billions in fines, it shouldn’t get a tax break for those same misdeeds, it should be held accountable. The current tax loophole is the worst kind of special-interest tax giveaway because it is allowing bad actors to subsidize their misdeeds. The law needs to change to ensure the punishment fits the crime. Congress needs to close this settlement loophole,” said Reed. “Federal agencies can take a more active, effective role in protecting taxpayers. Several federal entities have included specific clauses in their settlement agreements to prohibit penalties associated with the settlement from being deducted as a business expense. I urge more agencies to follow suit and publicly disclose the true value of these agreements.”

“A penalty should be meaningful or it won’t have the deterrent effect it’s supposed to have,” Grassley said. “Federal agencies too often don’t consider the tax implications, but you can be sure the company does. The government should understand this. The public should be accurately informed of the real penalty even when taxes are considered. This bill will ensure that government agencies think of the tax consequences in settlements going forward and increase transparency for the public.”

Under the federal tax code, the tax write-off for a $100 million settlement agreement could be worth as much as $35 million for the corporation being punished.

Summary: The Government Settlement Transparency & Reform Act

Closes tax loophole that allows tax write-offs for corporate violations.

The bill would amend the tax code to deny tax deductions for certain fines, penalties, and other amounts related to a violation or investigation or inquiry into the potential violation of any law.

It amends subsection (f) of Section 162 of the Internal Revenue Code. Amounts paid by corporations, which constitute restitution for damage caused by the violation of any law are exempted and remain deductible. The bill requires that nongovernmental entities which exercise self-regulatory powers be treated as government entities for purposes of disallowing deductions under this section. It also requires the government to stipulate the tax treatment of the settlement agreement.