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No Subsidies for Consumer Ripoffs

Imagine enjoying a tax windfall for violating consumer protection laws or mistreating customers. Unfortunately, some of America's largest corporations have done just that. In recent years, some companies that have been charged with slipping unexpected charges onto cell phone bills, illegally fixing prices and even racially discriminating against customers have then written off part or all of the cost of their wrongdoing on their taxes.

It is time federal and state governments stopped letting wrongdoers add insult to injury by passing off the costs of their misconduct to taxpayers.

Price-fixing and Collusion at Marsh & McLennan

In the early 2000s, Marsh & McLennan, the country's largest insurance broker, was accused by New York state officials of padding its bottom line by rigging bids for insurance contracts and steering customers toward favored insurers. The victims of the broker's alleged misconduct ranged from large companies to individual consumers.[1]

To resolve the civil charges it faced, Marsh & McLennan entered into an $850 million settlement agreement in 2005 to support a compensation fund for harmed clients. New York's then-attorney general, Eliot Spitzer, hailed the payout as a way for the company to break with past practices.[2] However, tax experts warned that by writing off the settlement, the broker could enjoy tax savings worth almost $300 million.[3]

Robo-signing Foreclosures at Goldman Sachs and Morgan Stanley

As the foreclosure crisis deepened in the late 2000s, banks like Goldman Sachs and Morgan Stanley were charged with improperly foreclosing on hundreds of thousands of mortgages after failing to properly review documents and instead automatically approving foreclosures. This practice of "robo-signing" helped the companies quickly get these properties off their books but left thousands of foreclosed families in legal limbo and even led to the improper seizure of homes.

In January 2013, Goldman Sachs and Morgan Stanley lawyers cut a deal with authorities to avoid charges over their role in the scandal in return for a total of $557 million.[4] But as media outlets pointed out, the financial giants were not expected to bear the full weight of the payout – thanks to the availability of a tax deduction, they could shift much of the cost back onto everyday taxpayers.[5]

Unwanted Cell Phone Charges from Jesta Digital

According to the Federal Trade Commission, starting in August 2011 Jesta Digital, a mobile marketer, ran phony ads on smartphone devices that led consumers to landing pages that, when clicked, sneaked a $9.99 monthly charge onto the consumer's cell phone bill. To resolve the accusations, Jesta Digital agreed in August 2013 to refund overbilled consumers and pay $1.2 million directly to the Federal Trade Commission. But because the settlement agreement did not specifically prohibit it, the door was left open for the company to deduct the total on its taxes.[6]

Racial Discrimination against Mortgage Borrowers at Bank of America

In late 2011, the federal Department of Justice accused Bank of America's Countrywide Financial branch of discriminating against black and Hispanic borrowers by steering more than 200,000 of them into riskier, "subprime" mortgages, and charging higher mortgage fees than the company charged comparable white borrowers. To settle the claims, Bank of America cut a $335 million deal with the Department of Justice, but because the bank was free to deduct the payout from its tax liability, it could reduce the financial hit by as much $117 million.[7]

When Corporations Do Wrong, the Public Often Picks Up the Tab

Marsh & McLennan, Goldman Sachs, Morgan Stanley, Jesta Digital and Bank of America allegedly engaged in illegal behavior that mistreated or ripped off consumers. Yet, rather than paying the full price of their misdeeds, these companies agreed to settlements with government regulators that allow them to take a tax deduction for all or part of the cost of the payout.

How can this happen? Though corporations cannot legally write off public penalties or fines as tax breaks, companies *may* be able to write off payments made to make amends for their bad behavior as a normal business expense.[8] This is because government agencies often fail to define a settlement's deductibility in the formal agreement.[9] This ambiguity, clouded further by complicated case law, creates a **settlement loophole** corporations can take advantage of to secure a discount on their payout.[10] The IRS states that "almost every defendant/taxpayer deducts the entire amount" of their financial settlement with the government as a business expense.[11] According to a 2005 government study of 34 companies' settlements worth more than $1 billion, 20 companies deducted some or all of their payments.[12]

Every dollar in tax savings companies enjoy in this way is ultimately paid for by ordinary Americans in the form of program cuts, increased federal debt, or higher taxes to make up the difference.

Stop Subsidizing Consumer Ripoffs

Taxpayers should not be forced to subsidize corporations that violate rules designed to protect the public from ripoffs, environmental damage, fraud or the selling of dangerous products.

All settlement agreements should clearly define their tax consequences and communicate that information clearly to the corporation, the IRS and the broader public. In addition, government agencies should:

- Make all settlement payouts non-deductible by default, including standard language in all agreements to that effect. The Environmental Protection Agency often does this and the Securities and Exchange Commission increasingly does the same.[13]
- Publicly disclose all settlements on agency websites and include information about any portion that corporations have not been barred from deducting on their taxes.
- Require corporate filings to the Securities and Exchange Commission to explain whether any settlement payments were written off.
- Ensure "truth in advertising" by requiring regulators and corporations to disclose the *after-tax* amounts of settlements, a more accurate portrayal of the penalty a company will really pay.

U.S. PIRG
Standing Up To Powerful Interests

MAIN OFFICE:
44 Winter Street, 4th Fl.
Boston, MA 02108
(617) 747-4370

FEDERAL OFFICE:
218 D Street SE, 1st Fl.
Washington, DC 20003
(202) 546-9707

Notes

1 Thor Valdmanis, Adam Shell and Elliot Blair Smith, "Marsh & McLennan Accused of Price Fixing, Collusion," *USA Today*, 15 October 2004.

2 "Marsh & McLennan Settles Charges," *The New York Times*, 1 February 2005.

3 Ian McDonald, "Marsh's Settlement Looks Likely Eligible for a Tax Deduction," *The Wall Street Journal*, 7 February 2005.

4 "2 Banks To Pay $557 Million In Foreclosure Settlement," *The Associated Press*, 16 January 2013.

5 Marcy Gordon, "Taxpayers Will Ease Banks' Costs in Mortgage Deal," *The Associated Press*, 17 January 2013.

6 Federal Trade Commission, *Jesta Digital Settles FTC Complaint It Crammed Charges on Consumers Mobile Bills Through "Scareware" and Misuse Of Novel Billing Method* (press release), 21 August 2013; *Federal Trade Commission v. Jesta Digital, LLC*, No. 1:13-CV-01272, U.S. District Court for the District of Columbia, 20 August 2013.

7 Settlement: Brady Dennis, "Bank of America to Pay $335M to Settle Claims of Unfair Countrywide Loans," *The Washington Post*, 21 December 2011; Potential tax deduction: Danielle Douglas, "Hidden Cost: Corporations See Lower Tax Bill When They Settle With the Government," *The Washington Post*, 12 October 2012.

8 26 CFR §1.162-21.

9 For more, see: Phineas Baxandall and Ryan Pierannunzi, U.S. PIRG Education Fund, *Subsidizing Bad Behavior: How Corporate Legal Settlements for Harming the Public Become Lucrative Tax Write Offs, with Recommendations for Reform*, January 2013.

10 Robert W. Wood, "Cleaning Up: Tax Deductions for Restitution, Fines, and Penalties," *Tax Notes*, 26 January 2009.

11 Internal Revenue Service, *Attachment I to Industry Director Directive on Government Settlements Directive #1*, 17 January 2013, downloaded from http://www.irs.gov/Businesses, 17 October 2013. Note: though the source of this quotation is an IRS memorandum attachment dealing specifically with False Claims Act and Environmental Protection Agency settlements, the original IRS document makes clear that its discussion "can apply to any settlement between a government entity and a defendant under any law in which a penalty can be assessed," per John Risacher, Internal Revenue Service, *Tier I Issue: Government Settlements Directive #1*, 30 May 2007.

12 United States Government Accountability Office, *Systematic Information Sharing Would Help IRS Determine the Deductibility of Civil Settlement Payments*, 15 September 2005.

13 The EPA often bars deductibility: Douglas H. Frazer and Karen M. Schapiro, "Tax Deductions for Settlements with Government Agencies," *Wisconsin Lawyer* 76 (3), March 2003, note 13; for the most well-known instance of the SEC barring tax deductibility, see: *Securities and Exchange Commission v. Goldman, Sachs & Co. and Fabrice Tourre*, No. 10-CV-3229, S.D. New York, 14 July 2010.