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No Tax Write-Offs for Health Care Fraud

Imagine enjoying a tax windfall for breaking the law, committing fraud, or even endangering someone's health. Unfortunately, it has happened all too often in the healthcare and pharmaceutical industries. When alleged fraudsters have been charged with ripping off taxpayer-funded programs such as Medicare or illegally

marketing drugs for unapproved purposes, many have written off part of the cost of their wrongdoing on their taxes.

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



Kickbacks and Fraud at Fresenius Medical Care Holdings

In the 1990s, three wholly-owned subsidiaries of Fresenius Medical Care Holdings, a German dialysis provider, were accused by authorities of falsely billing Medicare for unnecessary blood tests and using illegal kickbacks – including bear-hunting excursions in Alaska – to encourage healthcare providers to partner with the company.

In January 2000, Fresenius' lawyers cut a deal with the federal government to settle criminal and civil charges by paying \$486 million, \$385 million of which went toward the civil claims.¹ Fresenius deducted most of the civil payment from its tax liability, but the IRS launched a legal challenge which temporarily blocked the deduction while the case moved through the courts. Once the ruling came down in Fresenius' favor, the company claimed a \$50 million tax refund equal to the tax savings it would have enjoyed had it initially made the full tax write-off.²



Illegal Marketing at Wyeth Pharmaceuticals

Throughout the 2000s, Oklahoma-based Wyeth Pharmaceuticals – now a part of pharmaceutical giant Pfizer – allegedly trained its sales force to illegally market its kidney-transplant treatment Rapamune to recipients of other transplanted organs. The company's actions – known as “off-label marketing” – aimed to increase the company's sales but posed an enormous health risk to patients. In the summer of 2013, Wyeth agreed to pay \$491 million to resolve criminal and civil charges, including a \$257 million civil settlement with the Department of Justice that failed to explicitly bar Wyeth from deducting this cost.³



Illegal Kickbacks to Doctors at Amgen

Following the Food and Drug Administration's approval in 2010 of Amgen's cancer drug Xgeva, the California-based company allegedly used illegal kickbacks to encourage physicians to prescribe the drug, providing cash payments to doctors who recorded prescribing Xgeva in a survey conducted by the company. In July 2013, Amgen settled with the federal Department of Justice over the charges, resolving the case with a \$15 million settlement that failed to prohibit the company from writing off the costs as a tax deduction.⁴ IRS experience suggests that Amgen is likely to write off this settlement.



Defrauding Government Healthcare Programs at Shands Healthcare

Between 2003 and 2008, Florida-based Shands Healthcare allegedly defrauded Medicare, Medicaid and TRICARE – the military's healthcare program – at six hospitals in Florida by knowingly submitting false claims in an effort to bill outpatient services as more expensive inpatient care.⁵ Shands agreed in the summer of 2013 to pay \$26 million to the federal Department of Justice in a settlement that failed to prohibit the healthcare provider from writing off the payout, making it likely that Shands will deduct this payout from its tax liability.⁶

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

Fresenius, Wyeth Pharmaceuticals, Amgen and Shands Healthcare allegedly engaged in illegal behavior that ripped off taxpayers or threatened the health of patients. Yet, rather than paying the full price of their misdeeds, federal law opens the door for companies that agree to settlements with government regulators 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 settle allegations of wrongdoing by treating such payments as an ordinary and necessary business expense.⁷ This is because government agencies often fail to define a settlement's deductibility in the formal settlement agreement.⁸ This ambiguity, clouded further by complicated case law, creates a **settlement loophole** corporations can take advantage of to secure a discount on their payout. According to the IRS, in

settlements like those described above, "almost every defendant/taxpayer deducts the entire amount" as a business expense.⁹ A 2005 Government Accountability Office study of 34 companies' settlements, worth more than \$1 billion, found that 20 companies deducted some or all of their payments.¹⁰

This is exactly what happened in the Fresenius case: the company ended up successfully deducting \$353 million of its \$385 million civil settlement – shifting over \$100 million back onto taxpayers.¹¹ And in more bad news for American taxpayers, Wyeth, Amgen and Shands Healthcare all entered into settlement agreements that, in the IRS' experience, typically result in companies handing much of the bill for their misdeeds to everyday taxpayers.

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 Healthcare Fraud

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

The federal government should require all settlement agreements to clearly define their tax consequences and to 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 Se-

curities and Exchange Commission increasingly does the same.¹²

- 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.

Notes

- 1 Milt Freudenheim, "Dialysis Provider To Pay \$486 Million To Settle Charges," *The New York Times*, 20 January 2000.
- 2 Shearman & Sterling LLP, *US District Court Rejects Talley and Permits a Business Expense Deduction for Part of Double Damages Payment Under the False Claims Act*, 21 May 2013.
- 3 United States Department of Justice, *Wyeth Pharmaceuticals Agrees to Pay \$490.9 Million for Marketing the Prescription Drug Rapamune for Unapproved Uses* (press release), 30 July 2013; United States Department of Justice, *Settlement Agreement: The United States of America; Pfizer, Inc. and Wyeth Pharmaceuticals, Inc.; Relators: Marlene Sandler and Scott Paris; and Relator: Mark. B Campbell*, 30 July 2013, available at www.elsevierbi.com/~media/Supporting%20Documents/The%20Pink%20Sheet%20DAILY/2013/July/Rapamune%20Cases_Executed%20Settlement%20Agreement%200713.pdf.
- 4 Corporate Crime Reporter, "Amgen Pays Over \$15 Million to Settle False Claims Charge," 17 July 2013; United States Attorney's Office, Central District of California, *Ventura County-based Amgen Inc. Pays Over \$15 Million to Resolve Allegations That It Illegally Marketed Cancer Drug with Kickbacks* (press release), 11 July 2013.
- 5 Alleged fraud by Shands Healthcare: United States Department of Justice, *Shands Healthcare to Pay \$26 Million to Resolve Allegations Related to Inpatient Stays at Six Florida Hospitals* (press release), 19 August 2013; cost of inpatient care: Stuart Wright, Office of Inspector General, *Memorandum Report: Hospitals' Use of Observation Stays and Short Inpatient Stays for Medicare Beneficiaries*, 29 July 2013.
- 6 Ibid., "Shands Healthcare."
- 7 26 CFR §1.162-21.
- 8 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.
- 9 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: this quotation is sourced from an attachment to an IRS memorandum dealing specifically with False Claim Act settlements (of which Fresenius, Wyeth, Amgen and Shands Healthcare are examples). False Claims Act settlements are particularly common and are typically settled by the Department of Justice (DOJ). Though the original IRS memorandum's discussion emphasized DOJ and EPA settlements in particular, it "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.
- 10 United States Government Accountability Office, *Systematic Information Sharing Would Help IRS Determine the Deductibility of Civil Settlement Payments*, 15 September 2005.
- 11 Shearman & Sterling LLP, *US District Court Rejects Talley and Permits a Business Expense Deduction for Part of Double Damages Payment Under the False Claims Act*, 21 May 2013.
- 12 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.