

# *U.S. Senate Committee on Finance*

For Immediate Release

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## **Grassley, Baucus Question Civil Settlement Tax Deductions** *Senators Will Introduce Legislation To Clarify Tax Deduction Requirements*

(WASHINGTON, D.C.) Senator Chuck Grassley, chairman of the Senate Finance Committee, and Senator Max Baucus, ranking member, questioned companies using civil settlements as tax deductions after the Government Accountability Office (GAO) released a study showing a number of companies using the settlements as deductions on tax returns.

The two senators requested the study and will introduce legislation as early as today that would require settlement agreements to specify whether the payments are for non-deductible penalties and would limit deductions to the amounts paid for restitution or to come into compliance with the law. In addition, the legislation would require agencies to send information reports to the IRS so these deductions can be tracked and audited.

The Government Accountability Office (GAO) released a study today examining the tax treatment of civil settlements between companies and government agencies that found many of these settlements are taken as a tax deduction. Civil settlements are enforcement tools used by government agencies to resolve violations of the law and punish companies short of going to court. They may include penalties or compensatory damages. The annual value of these settlements can exceed billions of dollars. Amounts paid for fines and penalties are not allowable as tax deductions.

The GAO studied civil settlements from the Environmental Protection Agency (EPA), the Securities Exchange Commission (SEC), the Department of Justice (DOJ), and the Department of Health and Human Services (HHS) ranging from \$870,000 to \$1 billion. In response to a survey conducted as part of the study several companies reported they deducted all or part of twenty out of thirty-four settlements, often because the agreements did not address tax treatment of the payments or because they interpreted the tax law in their favor.

The Internal Revenue Service (IRS) and other government agencies have no routine process to share information about these settlements, leaving many deductions undetected and unaudited. As a result of the GAO study, two companies found mistakes in taking settlement deductions for their settlements and indicated they would file amended tax returns. The GAO recommended the IRS and the agencies develop a communication process to share settlement information so the IRS could follow-up on the tax treatment of the payments.

After the report was released, Senator Grassley and Senator Baucus the following comments:

### Senator Grassley Quote:

“A civil settlement is supposed to sting like a bee, not annoy like a gnat. Letting companies deduct settlement payments from their income taxes takes away the sting. It minimizes the deterrent effect, and it makes chumps out of the taxpayers who subsidize these deductions. And it all could be avoided if government agencies just work with the IRS and not at cross-purposes. The revised bill

that Senator Baucus and I are introducing will make clearer what can and can't be deducted and give the IRS the information it needs on the front end to make sure payments are treated properly for tax purposes.”

Senator Baucus Quote:

“Companies being punished for violating the law should not be able to subsidize their penalties settlements through a tax deduction. It is galling that artfully crafted settlement agreements create loopholes that allow wrongdoers to escape the full impact of fines and water down any deterrent effect. It is unacceptable that government agencies routinely do not share settlement information with the IRS so payments and deductions can be monitored. The GAO report confirms what many have suspected for some time -- that companies were shifting the cost of their fines and penalties onto the backs to honest taxpayers.”

The full text of the report, “Tax Administration: Systematic Information Sharing Would Help IRS”, GAO-05-747, can be found on the GAO website at <http://www.gao.gov/>.

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