



Highlights of [GAO-05-747](#), a report to the Committee on Finance, U.S. Senate

Why GAO Did This Study

Although some civil settlement payments are deductible, their deterrence factor could be lessened if companies can deduct certain settlement payments from their income taxes. GAO was asked to (1) identify federal agencies that negotiated some of the largest dollar civil settlements, (2) determine whether selected federal agencies take tax consequences into account when negotiating settlements and officials' views on whether they should address payment deductibility in settlement agreements, (3) determine whether companies with some of the largest civil settlement payments deducted any of the payments on their federal income taxes, and (4) determine what information the Internal Revenue Service (IRS) collects on civil settlements reached by federal agencies.

What GAO Recommends

GAO recommends that IRS work with federal agencies to develop a cost-effective means of systematically obtaining information on civil settlements that would benefit IRS in ensuring the correct tax treatment of settlement payments.

IRS agreed with the recommendation and will form an executive-led team to implement it. EPA generally supported our recommendation and the other agencies did not address the recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-05-747.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov.

TAX ADMINISTRATION

Systematic Information Sharing Would Help IRS Determine the Deductibility of Civil Settlement Payments

What GAO Found

The Environmental Protection Agency (EPA), Securities and Exchange Commission (SEC), and Department of Justice (DOJ) negotiated civil settlements that were among the largest in the federal government in fiscal years 2001 and 2002. Also, the Department of Health and Human Services (HHS) was involved in negotiating some of the largest dollar False Claims Act (FCA) health-care civil settlements for which DOJ has primary responsibility. The largest civil settlements at these agencies ranged from about \$870 thousand to over \$1 billion.

Officials in the four agencies we surveyed said that they do not negotiate with settling companies about whether settlement amounts are tax deductible. They said it was IRS's role to determine deductibility. In preparing to negotiate environmental settlements, EPA and DOJ may consider certain tax issues in calculating the amounts they propose to seek. This calculation estimates a company's economic benefit, that is, the financial gain from not complying with the law. Some DOJ environmental settlements with civil penalties have language stating that penalties are not deductible. DOJ officials said since the law is generally clear that civil penalties paid to a government are not deductible, stating so in the agreement was merely restating the law and is not necessary.

The majority of companies responding to GAO's survey on how they treated civil settlement payments for federal income tax purposes deducted civil settlement payments when their settlement agreements did not label the payments as penalties. GAO received responses on 34 settlements totaling over \$1 billion. For 20 settlements, companies reported deducting some portion or all of their settlement payments.

IRS does not systematically receive civil settlement information from all four agencies. IRS officials said that a permanent system for agencies to provide information would be useful. IRS obtains information on a case-by-case basis from public sources and agencies. IRS also has two temporary compliance projects focusing on tax issues that affect settlement payment deductibility. In 2004, IRS introduced a tax schedule to provide information on a company's fines, penalties, and punitive damages.

Approximate Ranges and Cumulative Values of the 20 Largest Civil Settlement Agreements at the Four Agencies Contacted in Each Year for Both Fiscal Years 2001 and 2002

Agency	Smallest	Largest	Cumulative value
EPA	\$1 million	\$1 billion	\$4.1 billion
SEC	\$870 thousand	\$114 million	\$607 million
HHS	\$3 million	\$790 million	\$2 billion
DOJ	\$12 million	\$471 million	\$3.3 billion

Source: GAO analysis of EPA, SEC, HHS, and DOJ data.

Note: Settlement values include payments to the U.S. government. EPA settlements also include estimated costs for any pollution controls, other complying actions and Supplemental Environmental Projects. HHS settlements are for FCA cases negotiated with DOJ. EPA settlements led by DOJ are included in the EPA category.