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Elon Musk's $40M SEC Settlement; Nice Tax Deduction?

The SEC lawsuit over Tesla CEO Elon Musk's tweet was settled, fast as a tweet. You have to hand it to Musk. After his famous 'taking private' tweet in early August, rumblings began that the SEC was not happy and was doing some digging. The story wouldn't go away, even though Musk did his best to keep the news media busy with other activities unusual for a public company CEO. Then last week, after an investigation and presumably some unsuccessful back and forth between the SEC and representatives of Musk and Tesla, the SEC filed an action against him. Then, mere days later, over the weekend, Musk and Tesla settled it, just like that.

Tesla and Musk are to pay $40 million in fines, and to make some concessions. Among them, Musk gets to remain CEO, but steps down as chairman for at least three years. In return, the suit alleging that Musk duped investors with misleading statements about a proposed buyout will go away. The $40 million in fines is to be split between them, $20 million for Tesla, $20 million for Musk. The deal was announced Saturday, just two days after the SEC filed its case seeking to oust Musk as CEO. A $20 million payment might seem like a lot for a tweet, but arguably not to Musk, whose estimated fortune is $20 billion. Tesla has plenty of cash too, something on the order of $2.2 billion.

But can Musk and/or Tesla write off the payment on their taxes? It isn't a silly question. The SEC's statement regarding the agreed settlements doesn't say. UPDATE: One court filing says that Tesla expressly agreed *not* to claim a tax deduction for its $20 million. Apart from that agreement, the tax write-offs may not be prohibited. After all, the SEC says that the $40 million in penalties will be distributed to harmed investors under a court-approved process. That rebate-sounding idea sounds a lot like restitution. And that could be a door to Tesla and Musk deducting the "fines." But aren't fines always non-deductible? Not so fast.

Section 162(f) of the tax code prohibits deducting any fine or similar penalty paid to a government for the violation of any law. That includes criminal and civil penalties, as well as sums paid to settle potential liability for a fine. But the law is riddled with exceptions, and creative companies can often find a way to write off even the biggest fines. After all, many fines are not made to punish, but to fund some kind of remediation, and that can make a difference. For example, BP probably could write off a majority of its $20.8 billion out-of-court settlement related to the Gulf Oil spill. The deal designated only about one quarter, $5.5 billion, as a non-tax-deductible Clean Water Act penalty.

The tax rules were tightened by the tax reform law enacted in December of 2017. Even under the new rules, though, it is permissible to write off certain payments of restitution or amounts paid to come into compliance with law. It is not clear whether Musk or Tesla qualify, but they might, barring some kind of explicit no-deduction provision. Tesla evidently did agree NOT to claim a deduction, and explicit provisions about taxes appear in settlement agreements are becoming more common. For example, the Department of Justice expressly blocked Credit Suisse from deducting its $2.6 billion settlement for helping Americans evade taxes. Ditto for the BNPP terror settlement, which states that BNPP will not claim a tax deduction. Musk at least might be able to steer clear of such prohibitions. And that could sweeten the deal.

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.