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Trump University Settlement Nets $25M Write-Off For Trump, Taxes For Students

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It is now official: the Trump University settlement was approved in court. Efforts to derail it failed, and the case will soon be a legal footnote. Not long ago, then President-elect Donald J. Trump agreed to pay $25 million to settle the suits over Trump University. Many former Trump University students have claimed a share of the $25 million settlement. They should recover about 80 percent of the money they spent, according to Bloomberg Law. Plaintiffs claimed the university made false promises of riches and instant success. Trump fought the allegations for years, but finally agreed to the deal. A filing says that a total of 2,471 claims seeking $21.3 million in refunds have been verified.

Of the total, $21 million is for ex-students nationwide covered by two class actions. The remaining $4 million is for students represented by the New York attorney general. Mr. Trump has admitted no wrongdoing, yet he long maintained that he would *never* settle. The plaintiffs alleged that they paid up to $35,000 in tuition for little in return. And the New York Attorney General complained too. The deal resolves two federal class-action cases, plus a separate lawsuit by New York Attorney General Eric T. Schneiderman.

Students get most of the money, but New York State itself is collecting up to a $1 million penalty for alleged violations of state education laws. Do the students get to keep the 80% of their money they are getting back? Not entirely. Students receiving refunds may be surprised to learn that they will have taxes to pay. Litigation settlements are usually taxed unless they are for physical injuries, which these settlements clearly are not. It is one of the many things to know about taxes on legal settlements. It often means a plaintiff collecting could lose up to half to the IRS and to state tax agencies. It can seem like a double-whammy.

Notably, many students probably did not deduct the costs of Trump University on their taxes in the first place. In that sense, they are really coming up short when they have to pay taxes on their settlements. Curiously, though, there should be little doubt about Mr. Trump's tax treatment. He should be able to deduct it, so that the *real* cost of the settlement to Mr. Trump is *after tax*. This is not Mr. Trump's doing, but just a feature of nearly all business litigation. Most business settlements are fully tax deductible.

The only portion of the case that arguably may not be a tax write-off to Mr. Trump is the $1 million in penalties paid to New York. In general, fines and penalties paid to the government are not deductible. Section 162(f) of the tax code prohibits deducting ''any fine or similar penalty paid to a government for the violation of any law.'' Yet, barring express agreements in settlements not to deduct something, many penalties can be deducted, too. For one thing, despite punitive sounding names, some fines and penalties are considered remedial and deductible. That allows some flexibility.

Companies often deduct 'compensatory penalties,' a maneuver affirmed in a recent Circuit Court ruling. Some defendants insist that their settlement agreement confirms that the payments are not penalties and are remedial. Conversely, some government entities insist on the reverse. Explicit provisions about taxes in settlement agreements are becoming more common. For example, the Department of Justice did expressly forbid 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.

Sometimes the government and a defendant split the baby. Of the $13 billion JP Morgan settlement struck in late 2013, only $2 billion was said to be nondeductible. The DOJ doesn't always disclose the terms of settlements either. But that could change. The proposed Truth in Settlements Act (S. 1898 – fact sheet) would require agencies to report after-tax settlement values. Another bill, S. 1654, would restrict tax deductibility and require agencies to spell out the tax status of settlements. The U.S. Public Interest Research Group tracks the tax implications of legal settlements, and they are not easy on the DOJ, saying that the DOJ should forbid deductibility. A poll released by the U.S. Public Interest Research Group Education Fund says most people disapprove of deductible settlements. U.S. PIRG has also created a fact sheet on Wall Street settlement tax deductions.

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