McDermott, Inc. v. Commissioner, 93 T. C. 217 (1989)

Settlement payments under the Clayton Act are subject to the limitations of section 162(g) of the Internal Revenue Code if they are 'on account of' the same conduct admitted in a related criminal antitrust proceeding.

Summary

McDermott, Inc. faced a tax dispute over the deductibility of settlement payments made to plaintiffs in a consolidated Clayton Act antitrust litigation following its nolo contendere plea to Sherman Act violations. The Tax Court held that payments related to bid-rigging contracts, both targeted and nontargeted, were subject to section 162(g)'s limitation, disallowing deductions for two-thirds of such payments. However, payments related to negotiated contracts were fully deductible under section 162(a). The decision hinged on the interpretation of 'on account of such violation' in section 162(g), focusing on whether the civil settlements were essentially coextensive with the criminal conduct admitted.

Facts

McDermott, Inc. , a marine construction company, was indicted alongside Brown & Root, Inc. , for bid rigging and other anticompetitive practices in violation of the Sherman Act. Following a plea agreement, McDermott pleaded nolo contendere to these charges. Subsequently, over 60 companies initiated Clayton Act lawsuits against McDermott for treble damages. McDermott settled these claims using a formula based on the type of contract involved: targeted bid contracts, nontargeted bid contracts, and negotiated contracts. The settlements amounted to $93,959,034, with different rates applied to each contract type. McDermott sought to deduct these payments under section 162(a) of the Internal Revenue Code, but the Commissioner challenged the deductibility under section 162(g).

Procedural History

McDermott and the Commissioner filed cross-motions for partial summary judgment in the U. S. Tax Court regarding the deductibility of the settlement payments. The court needed to determine whether these payments were subject to the limitations of section 162(g) due to McDermott's nolo contendere plea in the criminal antitrust case.

Issue(s)

1. Whether payments made to settle claims related to targeted bid contracts are deductible under section 162(g)?
2. Whether payments made to settle claims related to nontargeted bid contracts are deductible under section 162(g)?
3. Whether payments made to settle claims related to negotiated contracts are deductible under section 162(g)?

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Holding

1. No, because the payments were ‘on account of’ the Sherman Act violation admitted in the criminal proceeding.
2. No, because the nontargeted bid contract settlements were essentially coextensive with the conduct admitted in the criminal proceeding.
3. Yes, because the negotiated contract settlements were not coextensive with the admitted criminal conduct.

Court’s Reasoning

The court interpreted ‘on account of such violation’ in section 162(g) to mean that the civil settlements must be essentially coextensive with the criminal conduct admitted. McDermott’s plea focused on bid rigging, which encompassed both targeted and nontargeted bid contracts, thus subjecting payments for these settlements to section 162(g). The court emphasized the origin and nature of the claims, not McDermott’s settlement motives, in determining the applicability of section 162(g). For negotiated contracts, the court found that the admitted criminal conduct did not extend to these, as the plea did not cover negotiated agreements, allowing full deductions under section 162(a). The court referenced Flintkote Co. v. United States and Federal Paper Board Co. v. Commissioner to support its analysis.

Practical Implications

This decision impacts how antitrust litigation settlements are treated for tax purposes. Companies facing antitrust allegations must carefully consider the scope of their criminal pleas to avoid unintended tax consequences in related civil settlements. The ruling clarifies that only settlements directly related to the criminal conduct admitted will be subject to section 162(g), potentially affecting settlement strategies in antitrust cases. Later cases, such as those involving similar issues of deductibility, will need to consider this ruling when determining the applicability of section 162(g). Additionally, this case underscores the importance of distinguishing between different types of contracts in antitrust litigation and their tax treatment.

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