



MEMORANDUM

TO: Members of the Senate Budget Committee
FROM: Alida Kass, Chief Counsel
SUBJECT: Senate Bill 3034
DATE: June 18, 2015

The New Jersey Civil Justice Institute is a statewide, bipartisan coalition of the state's largest employers, small businesses, and leading trade associations advocating for a fair and predictable civil justice system in New Jersey. On behalf of our members, **we respectfully oppose S-3034.**

Under current law, punitive damages are deductible as an ordinary business expense. This bill would disallow that deduction, on the theory that it is not appropriate to dilute the punitive effect of a punitive damage award. The punitive damage deduction has been characterized as a tax-loop-hole, presumably in contrast to the tax treatment of criminal fines, which are not deductible.

But there are important distinctions that underlie the different tax treatment of the two expenses. Criminal penalties are typically fixed by statute and defined by objective criteria; due process protections ensure that criminal statutes meet requisite standards for notice and clarity. Standards for punitive damages, on the other hand, as awarded in a jury verdict, are inherently arbitrary, and are required to meet lower underlying standards of proof.

Under current law, the money paid in punitive damages is taxed once by the state – when it is reported as taxable income by the plaintiff. This bill would impose double taxation on moneys paid as punitive damages. Double taxation is not only an abuse of the taxing authority, it would make the state a beneficiary of the litigation industry and give the state a financial stake in the proliferation of punitive damages.

Finally, under current law, the tax code is relatively neutral with respect to how payments are characterized. Regardless of whether they are deemed compensatory or punitive, the tax treatment of the payments made by the defendant is the same. By introducing a significant additional cost to awards that are characterized as punitive damages, the bill would create an incentive for plaintiffs and defendants to collude on the terms of settlements. Plaintiffs' and defendants' interests would align to deem all payments compensatory, so that neither party would owe taxes on the award.

No other state in the country has chosen to adopt such a proposal. The bill would generate significant uncertainty and would distort the incentives in the civil justice system. We would encourage the committee to hold the bill.