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New Tax Bill Eliminates Deductibility of Confidential Sexual Harassment Settlements

Although business-related settlement payments (and attorneys' fees) are generally tax-deductible, the 2017 Tax Cuts and Jobs Act (the Tax Act) restricts an employer's ability to obtain tax deductions for settlements of sexual harassment and abuse claims that are subject to nondisclosure agreements. I.R.C. Section 162(q) provides:

"(q) PAYMENTS RELATED TO SEXUAL HARASSMENT AND SEXUAL ABUSE. —No deduction shall be allowed under this chapter for—

- (1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or
- (2) attorney's fees related to such a settlement or payment."

This new deduction limitation applies to any payments made after December 22, 2017.

Although the Tax Act appears to increase an employer's cost to settle sexual harassment or abuse-related claims, the Tax Act leaves many questions unanswered. For instance:

- What is a claim "related to" "sexual harassment" or "sexual abuse"? The Tax Act does not **define** these terms.
- In cases where a plaintiff brings **multiple claims**, some of which pertain to sexual harassment or abuse, does the provision permit dismissal of the latter claims and confidential (as well as tax-deductible) settlement of the remaining claims? Can employers structure separate settlement agreements for non-sexual-harassment claims to maintain their deductibility?
- What are "**attorney's fees related** to such a settlement or payment"? Are fees incurred in the investigation and defense of the litigation generally non-deductible?
- Must a claim of sexual harassment or abuse be **supported by fact** to eliminate the deduction, or is mere allegation sufficient?

As a result, the Tax Act may have unintended consequences for the victims of sexual harassment and abuse. First, because the Tax Act increases the employer's cost of settlement relative to its cost of litigation, the Tax Act may provide an incentive for employers to more strenuously contest sexual harassment claims. Second, publicity-shy plaintiffs may be hesitant to resolve their claims without a guarantee of confidentiality, driving down settlement values due to their non-deductibility by the employer.

What Employers Should Do Now

At this time, it is uncertain if or when a technical corrections bill or IRS guidance clarifying these questions will be forthcoming. Until such time as IRS guidance or a technical corrections bill on the subject arrives, employers should:

- Use the opportunity to review policies and training materials on harassment and discrimination, including reviewing for compliance with applicable employment laws taking effect on January 1, 2018. California, for example, has expanded supervisory anti-harassment training to include content on gender identity, gender expression and sexual orientation harassment.
- Consult competent legal counsel from tax and employment law professionals prior to settling any sexual harassment or sexual abuse claims.

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