If Sex Harassment Claims Weren't "Unsettling" Enough

Employers can no longer deduct settlements and fees as business expenses

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Nearing the close of 2017 Congress and the White House scurried to give Americans a tax cut for Christmas. That law became a reality and it included many provisions including changes to individual and business tax rates. One little known provision of the Tax Cuts and Jobs Act (the "Act"), which was signed into law by President Trump on December 22, 2017 with many provisions becoming effective January 1, 2018, will have a large impact on settlement of "sexual harassment" or "sexual abuse" claims going forward. That provision amended Section 162 of the Internal Revenue Code, which generally allows taxpayers to deduct certain "ordinary and necessary operating expenses paid or incurred in running a trade or business." Those deductions now exclude payments related to sexual harassment and sexual abuse cases. Specifically, that means the IRS will no longer permit deductions from federal income taxes for:

> (1) any settlement or payment related to sexual harassment or sexual abuse <u>if such settlement or payment is subject to a nondisclosure agreement</u> (emphasis added), or
>
> (2) attorney's fees related to such a settlement or payment.

The applicable provisions of the Act apply to amounts paid or incurred after December 22, 2017. Under the Act, employers may now have to choose between deducting as business expenses settlement payments for sexual harassment or sexual abuse claims and maintaining the confidentiality of such settlements. Confidentiality is usually an important issue in these settlements.

And now the confusing part: The Legislative Committee Report accompanying the Act did not provide guidance as to the interpretation of the key statutory phrase "related to sexual harassment or sexual abuse," and those terms are also not defined elsewhere in the Act. Many discrimination and discharge cases involve multiple claims, not all of which are related to sexual harassment or sexual abuse. Therefore, employers may want to specifically allocate settlement payments to

claims other than sexual harassment or sexual abuse, if that decision is supported by the underlying facts of the case and its resolutions. Doing so may allow employers to continue to deduct as a business expense settlement payments and attorneys' fees for those cases involving multiple claims. It should be noted that this is speculation at this point because neither Congress, the IRS, nor any court has addressed this issue yet.

Other questions include: What if the other claims are related to gender discrimination but are plead under different terms (e.g. pregnancy discrimination, equal pay, etc.) and the facts could have constituted or supported a claim for sexual harassment or sexual abuse, would those settlements also be covered by the Act?

Another question is whether all fees attributable to an employer's defense of a sex harassment or sexual abuse case (e.g. investigation, counseling guidance, expert fees, negotiating and drafting the settlement agreement) would be excluded from deduction. What about the settlement of and fees related to retaliation claims? Those claims commonly accompany sexual harassment as well as other discrimination claims. Again, these are unresolved issues.

It is noteworthy that the Act applies not just to employers, but to both parties to the claim. For example, the plain language of the Act denies a deduction for all attorney's fees related to a sexual harassment or sexual abuse settlement payment, without regard to whether the fees were the responsibility of the recipient (the claimant) or the payor (in most cases, the company). Similarly, an employer is not entitled to a deduction even if it is the claimant who insists on a nondisclosure provision.

In light of the foregoing, and pending interpretive guidance from the IRS, employers must carefully weigh whether or not to include a nondisclosure provision in any settlement of a claim in which sexual harassment or sexual abuse is alleged without considering the tax consequences.

Until these questions are answered employers and their attorneys need to decide how to handle these settlement and related tax deductions. Possible solutions include:

- a separate settlement (with separate consideration) on the nondiscriminatory obligations
- requiring a voluntary nonsuit or withdrawal of claims;
- grossing up settlement to cover taxes
- employers getting tax advice before the settlement is finalized

- including language in general releases and settlement agreements that states clearly [this general release/settlement agreement] does not include asserted sexual harassment or sexual abuse claims

- the parties should include indemnification provisions to include tax treatment

In short, while many businesses and individuals have enjoyed the benefits of the Act, this provision has caused some degree of confusion for those who are involved in the resolution of such cases.

Stay tuned!

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