

# LABOR & EMPLOYMENT

>>ALERT

## TAX REFORM ELIMINATED DEDUCTIONS FOR CONFIDENTIAL SEXUAL HARASSMENT SETTLEMENTS

Effective for 2018, the Tax Cuts and Jobs Act of 2017 (TCJA) has eliminated deductions for settlements or payments related to sexual harassment or sexual abuse when such settlements or payments are subject to a nondisclosure or confidentiality agreement. This new law gives rise to several complexities that will need to be analyzed by employers considering confidential settlements. While the guidance on this change is currently limited (and we expect that additional guidance will be forthcoming), employers should start considering the potential impacts of this change.

### BACKGROUND

Prior to the passage of the TCJA, employers have historically been able to take a business deduction for settlements or payments related to sexual harassment or sexual abuse, even if such payments were subject to a nondisclosure agreement. Nondisclosure or confidentiality agreements, which are designed to prevent all parties from disclosing the terms of the agreement and the amount of any settlement payments, have become commonplace in sexual harassment settlements. In light of the current prominence of allegations of sexual harassment in the workplace, lawmakers have addressed this in the TCJA and prohibited a deduction for such payments.

### THE NEW LAW

Section 13307 of the TCJA provides that no deduction is allowed for (1) any settlement or payment related to sexual harassment or sexual abuse

### THE BOTTOM LINE

The TCJA now prohibits employers from taking business deductions for confidential settlements or payments related to sexual harassment or sexual abuse claims. Consulting counsel early on is critical, as this new law could increase the complexity and costs of such settlements. Additionally, the best way for a company to avoid sexual harassment claims is to prevent such claims in the first place, by implementing sexual harassment training programs and sound company policies and practices.

if such settlement or payment is subject to a nondisclosure agreement, or (2) attorneys' fees related to such a settlement or payment. The key is that in order to be deductible, settlement payments or attorneys' fees related to claims of sexual harassment or sexual abuse *may not* be subject to a nondisclosure or confidentiality agreement. In theory, lawmakers hoped this change would encourage greater transparency as employers may be less likely to keep such allegations confidential and thereby

protect the accused individual. However, it remains to be seen whether companies will be motivated to settle without confidentiality restrictions or whether the cost of settling a sexual harassment claim will be affected. In an area where employers and businesses have traditionally been very concerned with confidentiality, this change in the law may result in making confidential settlements of sexual harassment or sexual abuse claims even more expensive for employers.

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## ISSUES AND COMPLICATIONS

### **Sexual Harassment or Sexual Abuse as one of Multiple Claims**

Challenges will arise when sexual harassment or sexual abuse claims are settled simultaneously with other claims. If a settlement agreement with a nondisclosure provision covers multiple claims, one of which includes allegations of sexual harassment, as is often the case, it is unclear whether any portion of the settlement may be deducted. This same issue will arise with respect to attorneys' fees that apply to multiple claims, any of which involve sexual harassment and others which may arguably be "unrelated."

### **Victim's Attorneys' Fees May Not Be Deductible**

As written, the language of the TCJA seems to provide that all attorneys' fees related to a settlement of sexual harassment or sexual abuse claims subject to a nondisclosure agreement are not deductible. Taken literally, this means that even a victim's attorneys'

fees cannot be deducted. In some instances, this could be a deterrent for victims to bring claims (which is clearly not the intent of the change in the law). It remains to be seen whether further guidance will clarify the applicability of this provision.

### **"Related to" Sexual Harassment or Sexual Abuse**

Another issue with interpreting this provision in the TCJA is that "related to" sexual harassment or sexual abuse is not defined. Without further guidance, this will require greater analysis of separate claims and more strategy in determining settlement arrangements and agreements. Additionally, if an employer characterizes a payment subject to a nondisclosure agreement as not "related to" sexual harassment or sexual abuse and the Internal Revenue Service (IRS) disagrees, the employer will either have to accept the IRS determination or risk that the claims will be made public if challenged in court.

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