

Publications

Labor and Employment Alert: No More Tax Deduction for Certain Sexual Harassment Settlement Payments

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The tax bill signed by the president on December 22, 2017, changed the rules for deducting settlement payments and attorney's fees related to sexual harassment or sexual abuse claims. Any settlement payment related to sexual harassment or sexual abuse claims can no longer be deducted as a business expense if the payment is subject to nondisclosure or confidentiality provisions.

New Section 162(q) of the Internal Revenue Code provides:

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.

The language of this new provision, however, raises several questions. First, the provision refers to settlements or payments "related to" harassment or abuse. This ambiguous language raises the question of whether a deduction is permitted if only part of the settlement payment is "related to" sexual harassment or abuse or whether the provision applies instead only to settlements in which sexual misconduct is the sole claim being settled. Second, does there have to be evidence of harassment or abuse in order for the prohibition to apply, or is settlement of an unproven allegation sufficient? Third, what attorney's fees are "related to" the settlement or payment – the fees associated with negotiating the settlement or the fees for the time spent drafting the agreement or both? Presumably, the restriction on deducting attorney's fees relates to the attorney's fees incurred by the employer, but might conceivably include any fees paid to the claimant's counsel as part of a settlement arrangement.

Finally, while the bill seems intended to take away a tax deduction that might otherwise benefit offenders, the language nevertheless refers broadly to deductions "under this chapter," which could arguably refer to deductions beyond those authorized under Section 162. On its face, the language does not differentiate between victim and offenders.

Read in this way, the law would eliminate the tax deduction for attorney's fees by victims of sexual misconduct, as well as the businesses that employ the offenders, when they receive a settlement payment tied to a non-disclosure agreement.

These ambiguities aside, employers now face a choice when settling sexual harassment or sexual abuse claims: either permit the claimant to disclose or discuss the claims and retain the option to take a deduction for the settlement payment and attorney's fees as business expenses; or prohibit the claimant from disclosing or discussing the claims and the settlement payment and lose the deduction.

If you have questions about the impact of the new provision on settlement payments, contact your Vorys lawyer.