

## **New Tax Implications for Confidential Sexual Harassment Settlements**

Companies that have made confidential settlement payments related to sexual harassment claims should be aware that the recently enacted federal tax reform law, the Tax Cuts and Jobs Act, includes a provision prohibiting employers from deducting such confidential payments from business income, potentially making sexual harassment settlements more expensive for employers. Tax code section 162(q), states that no deduction shall be allowed 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 provision is effective for all amounts paid or incurred after December 22, 2017. Agreements created prior to December 22, 2017 may be adversely affected if they provide for payments after the enactment date.

Prior to the enactment of this provision, employers were generally able to deduct settlement payments and legal fees incurred during their defense of a sexual harassment claim. Now, section 162(q) denies employers a business expense deduction for any settlement or other payment related to a sexual abuse or harassment claim if the payment is subject to a confidentiality agreement. The bottom line is that employers now have to choose confidentiality *or* a tax deduction when settling a claim of sexual harassment in many cases.

There is little legislative history or guidance as to how to interpret the scope of section 162(q), including the term “related to sexual harassment or sexual abuse.” Certainly a question will arise in cases where sexual harassment is one of multiple claims whether, and how, to allocate payments into deductible versus non-deductible categories.

Another issue of widespread concern is how the IRS will treat payments made pursuant to a confidential separation agreement containing a general release of all claims, including for sexual harassment. Until the IRS provides guidance on this topic, employers may want to consider adding a representation to their separation agreements that the departing employee did not assert a claim of sexual harassment and that no portion of the separation payment is related to any claim of sexual harassment or sexual abuse.

Given the broad wording of the law, the IRS may also interpret it to impact a confidential severance payment to an accused harasser. Similarly, other expenses an employer might incur relating to a confidential settlement agreement of such claims might be impacted, such as the company’s own legal fees and other costs built into the settlement.

It is expected that the IRS will eventually issue guidance to clarify some of the ambiguities in section 162(q). In the meantime, employers draft settlement and other agreements to minimize any undesired effects of the new law and should consult their tax advisors with tax-related questions.

Attorneys at Kasowitz Benson Torres LLP have extensive experience and familiarity with negotiating settlement agreements and in defending sexual harassment and other employment-related claims. If you would like to discuss your employment-related matter with a Kasowitz

Benson Torres LLP attorney, please contact Mark Lerner (212-506-1728) or Jessica T. Rosenberg (212-506-1789).

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Key Takeaways:

- The recent federal tax reform law states that an employer's confidential settlement payment relating to a sexual harassment claim is no longer deductible from business income.
- The new law also prohibits deduction of other expenses relating to such confidential settlements, including legal fees and potentially other unspecified expenses.
- These payments and expenses are not impacted by this prohibition if they are not governed by a confidentiality requirement, so employers will want to carefully consider whether to include a confidentiality term in their settlement agreements.