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Tax Reform Act Denies Deductions for Confidential Settlements of Sexual Harassment Claims

A little-noted provision of the Tax Cuts and Jobs Act (the Act) signed by President Trump will have a large impact on settlement of "sexual harassment" or "sexual abuse" claims. This provision amends 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, to exclude the following:

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.

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.

The Committee Report accompanying the Act does not provide guidance as to the interpretation of the key statutory phrase "related to sexual harassment or sexual abuse," and those terms are not defined elsewhere in the Act. Many cases involve multiple claims, not all of which are related to sexual harassment or sexual abuse. 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. 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 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.

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