Tax Reform Act Denies Deductions for Some Sexual Harassment Settlements

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In a little-noticed provision buried deep inside the new Tax Cuts and Jobs Act (signed into law on Dec. 22) is the following “denial of deduction”:

“Payments related to sexual harassment and sexual abuse – No deduction shall be allowed under this chapter for
- any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement; or
- attorney’s fees related to such a settlement or payment.”

The statute adds a new Section 162(q) to the Internal Revenue Code, effective for amounts paid or incurred after December 22, 2017. Where applicable, it may require taxpayers to choose between non-deductibility of the payment and non-disclosure of the settlement.

The Conference Report accompanying the statute does not include any guidance as to the scope of the key statutory text: “related to sexual harassment or sexual abuse.” Because many cases involve multiple claims, only some of which may be “related to sexual harassment or sexual abuse,” careful planning and drafting of settlement and other agreements may be necessary to minimize the impact of this broad proscription. Where factually supportable, litigants may want to allocate settlement payments to claims other than sexual harassment or sexual abuse, possibly creating opportunities to deduct at least portions of settlement payments to claimants with multiple claims. Such allocations also may allow the deductibility of at least a portion of the attorney’s fees incurred in connection with the claims.

Also of interest is that the deductibility of attorney’s fees is not limited to fees incurred by defendants. Read literally, new Section 162(q)(2) would deny a deduction for all attorney’s fees related to “such a settlement or payment,” which presumably would include the fees paid by a plaintiff/settlement recipient as well, which may further complicate settlement negotiations. However, until and unless a statutory change is made (for example, in a technical corrections bill) or the Treasury or IRS releases interpretive guidance otherwise, litigants should carefully consider the effect of the statute’s plain text in their planning.

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