

The Rising Cost of "Hush Money" - Congress Strips Tax Incentives for Sexual Harassment Nondisclosure Agreements

Mark A. Konkel

January 23, 2018

You can count Congress among the institutions caught in the ground swell of the #MeToo movement, and they're using the tax code to prove it.

Buried in the various changes of the new tax bill, Congress included Section 13307, titled "Denial of Deduction for Settlements Subject to Nondisclosure Agreements Paid in Connection with Sexual Harassment or Sexual Abuse." Specifically, Section 13307 amends the Internal Revenue Code Section 162(q) to state:

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.

Effective for amounts paid or incurred after December 22, 2017, this deceptively complex provision will have broad impact for businesses attempting to resolve sexual harassment claims.

Generally speaking, the old language of Section 162 allowed payments made under settlement agreements and attorneys' fees paid in connection with the defense of an action as tax deductible for businesses as a business expense.

However, from the plain language of this new provision, businesses faced with the prospect of settling a sexual harassment claim will now have to make a choice - are they to choose between their bank account or their public image?

It is likely that confidentiality will still be the prevailing factor in the majority of these decisions.

Additionally, the language of Section 162 is unclear how this provision will treat the settlement of employment-related claims when an employee asserts multiple claims and some claims are not related to sexual harassment. Will the provision apply to the entire settlement payment? Should the payment be apportioned according to the separate claims? Will businesses also have to apportion their attorneys' fees in a similar fashion?

It is also uncertain how this provision will affect settlements of non-sexual harassment related claims where an employee will agree to a general release of all unasserted claims against the business (including unasserted sexual harassment claims). If the agreement includes a confidentiality

provision, will the payment trigger Section 162(q) and these payments cannot be deducted?

Until the IRS provides further guidance on how they will be enforcing this provision, businesses will have to proceed with caution when settling employment-related claims, especially sexual harassment claims.