

Settling sexual harassment claims may be more difficult under new tax law

Arguably the least-publicized aspect of the Tax Cuts and Jobs Act of 2017 is this significant change: employers may no longer deduct, as an ordinary business expense, monetary settlements of sexual harassment claims—if the employer wants the terms of the settlement to be kept confidential. Plus, employers can no longer deduct their attorneys' fees related to such confidential settlements.

The obvious public policy underlying these changes is to discourage the confidential settlement of these kinds of claims, thus no longer keeping others (fellow employees, potential claimants, and the public at large) in the dark pursuant to non-disclosure agreements. Employers can still enter into non-disclosure agreements regarding the terms of settlement of sexual harassment claims, but such a confidential settlement, and related attorneys' fees, will no longer be deductible as ordinary business expenses.

Employers and employees will have to do their own cost-benefit analysis of confidentiality. Obviously, with lower corporate tax rates, the financial penalty to an employer of a confidential settlement is diminished.

If a sexual harassment claim is only one of several claims asserted against an employer, can the employer apportion the settlement amount over all of the claims, thus maximizing its tax advantage from the confidential settlement of the other (non-sexual harassment) claims? The new tax law is not crystal clear on this question.

Nor is the law clear on the tax consequences to an employee if the employee—not the employer—insists on non-disclosure of the settlement. For example, if the employee insists on confidentiality of a settlement, would the employee's attorneys' fees be deductible or excludable from the employee's gross income? The express language of the new tax law provides that there is no deduction for attorneys' fees related to confidential settlements. Thus, it could be argued that the employee's attorneys' fees are not deductible or excludable from the employee's gross income—even though that does not appear to be the intent of the new law. The intent is to discourage employers from keeping these settlements confidential.

Employers and employees will have to grapple with these unanswered questions in the upcoming months and years as the Internal Revenue Service and courts interpret and apply various provisions of the new tax law. Perhaps Congress will have to amend certain aspects of the new tax law. As a general proposition, however, it is my personal opinion that this aspect of the new tax law will make settlements of sexual harassment claims more difficult to achieve. The road to hell is oftentimes paved with good intentions.

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