

## The 2017 Tax Bill's Quick Response to the #MeToo Movement Has Changed How Sexual Harassment Claims Are Settled



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The coincidental timing of the #MeToo movement and the negotiation of a major tax bill in late 2017 resulted in a small but important change to the federal tax code. A few sentences added very late in the negotiations of the tax bill last year are causing a dramatic shift in how employers are settling sexual harassment complaints.

Before the change, there had been two givens when an employer was resolving a sexual harassment claim. First, any settlement payment would be a deductible business expense. Second, virtually all settlement agreements would include a confidentiality provision precluding the claimant from disclosing the settlement and the circumstances surrounding the complaint.

These "hush" clauses have been the subject of much public criticism and commentary since Harvey Weinstein, Bill O'Reilly and others in the public eye were accused of serious acts of sexual harassment. There is a view that if the employers involved had faced public scrutiny early on for the conduct of their executives, the employers would have taken much more decisive action to prevent further harassment. The federal tax code might not seem the likely

place that politicians would turn to take up this issue. But the quickly-changed tax code in 2017 has made it much more expensive for employers if they seek to keep a settlement of a sexual harassment claim confidential.

Section 162 of the federal tax code generally lists business expenses that are tax deductible. The 2017 tax bill adds a new § 162(q) which was effective December 22, 2017 and provides:

(q) 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.

Simple enough, right? Not so for attorneys who represent employers and employees attempting to settle sexual harassment-related claims.

What if the complaint involves a variety of claims, not just sexual harassment? Does the new law preclude any deduction even if the sexual harassment part of the complaint is not the major issue? There is nothing in the law that would preclude the plaintiff and the defendant from agreeing to allocate a portion of the settlement to the sexual harassment claim and a portion to other claims. For example, take a \$100,000 settlement of several claims in which the employer and complainant could agree to allocate \$20,000 to the sexual harassment claim. In that instance, \$20,000 of the settlement would not be tax deductible and one-fifth of the attorneys' fees would not be deductible either. There does not seem to be any reason why allocations wouldn't work to minimize the financial impact of this new section 162(q). Legal settlements are often allocated between claims for various business reasons. The employer needs to keep in mind, however, that

the IRS typically does not consider itself bound by an allocation in a settlement agreement.

There is also concern that section 162(q) was subject to inartful drafting and covers any attorney's fees paid – even those paid by the plaintiff. Plaintiffs have had an above-the-line deduction for legal fees in employment cases for several years now. The plain text of the legislation implies that the provision covers businesses and individuals alike. Although a bill has been introduced in Congress to correct this apparent error, given congressional gridlock before midterm elections in November, it is anyone's guess if this provision will get changed anytime soon.

Finally, the new section 126(q) has built-in assumptions that do not necessarily reflect reality. Some complainants do not want their settlements to be public. This new provision denies the tax deduction to the employer even if the complainant demands a confidentiality provision for their own privacy purposes. Further, this all-or-nothing elimination of the business expense deduction does not take into account legitimate reasons an employer sometimes settles sexual harassment claims – reasons that have nothing to do with protecting the likes of Harvey Weinstein or Bill O'Reilly. The unintended consequences of this new tax law may well be that more sexual harassment claims are litigated to conclusion and then if the employer prevails, they can deduct their attorneys' fees. In the end, legislating social policy through the tax code may not prove to be very effective but that remains to be seen.

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