



Alerts

No Tax Deduction for Confidential Settlements of Sexual Harassment and Sexual Abuse Claims—Effective Immediately

December 28, 2017

Insights for Employers

Last Friday, December 22, President Trump signed into law the most significant tax legislation in over 30 years. The changes are far reaching and many will affect employer-employee relationships. This alert addresses one very significant provision that took effect the day after the President signed the law.

Elimination of Deduction for Confidential Sexual Harassment or Sexual Abuse Settlements

Heightened public awareness of sexual harassment in the workplace has resulted in a change to the federal income tax treatment of settlements of claims of sexual harassment and sexual abuse. Under the new law, no taxpayer (neither the complaining party nor the payor) can now claim the settlement amount or attorney fees paid in a sexual harassment or sexual abuse case as a tax deduction, if those settlement terms are subject to a nondisclosure agreement.

The provision reads as follows:

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 settlement or payment.

Employers will now need to weigh the reputational benefit of keeping a settlement confidential against the financial cost of not claiming the settlement payout and associated legal fees as a deduction. Simple math dictates that the larger the settlement amount, the greater the financial cost of confidentiality. Employees who wish to settle their claim but want to preserve confidentiality may also find employers now less willing to settle on those terms.

Notably, other Title VII claims—e.g. race, religion, and national origin claims—are not subject to this new tax provision. In other words, employers can continue to negotiate settlement agreements with confidentiality terms and maintain the deduction for settlements of discrimination claims – other than sexual harassment and sexual abuse. Note that it is not clear how the deduction will be treated if a sexual harassment claim is combined with another Title VII claim.

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Service Areas

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Tax



Governmental employers are not affected by this change because they are not subject to federal income tax and therefore do not claim tax deductions for litigation settlements. To the extent any governmental entity resolves cases with employees, the motivation to negotiate a confidentiality provision has not been changed by the new tax law. The same would generally be true for tax-exempt employers.

Additional Changes

The new tax bill also includes a number of other changes that will affect the workplace and employers. We will be following up with another alert in the coming days that describes those changes in greater detail.

In the meantime, please contact your Hinshaw attorney to discuss changes that businesses should consider making in response to the new tax law.

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