Tax Deduction To Be Curtailed For Some Settlements Of Sex Harassment Claims

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The federal tax bill published late on Dec. 15 has a number of provisions that, if enacted, would deny an employer's ability to deduct payments made in settlement of employee claims. If the tax bill passes, the negotiation of both the nature of settlement payments/court awards and reporting to the IRS will become even more critical given its impact on the deductibility of settlement payments. Get your tax lawyer involved early in the negotiation to help you document your preferred tax reporting position. **No Deduction for Payments Made in Connection With Sexual Harassment or Sexual Abuse if the Settlement is Subject to a Non-Disclosure Agreement** *Current Law:* Payments by businesses or employers made to settle sexual harassment or abuse claims are currently deductible in general. *Proposed Law:* No deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such settlement or payments are subject to a nondisclosure agreement. There is no definition of "related to sexual harassment or sexual abuse" so it is likely that the IRS will have to promulgate regulations. The only surefire way to deduct such payments is to not include a nondisclosure provision in the settlement agreement. It seems unlikely that a payor would forego a nondisclosure provision in order to deduct these payments, but again, check with your tax lawyer. *Effective date:* Effective for such amounts paid or incurred after the date of enactment. **No Deduction for Payments in Violation of Law** Also looming is a provision that payments made or incurred to or at the direction of a governmental or specific nongovernmental entity for the violation or potential violation of any law will be nondeductible and reportable to the IRS and the payee. While fines and penalties are nondeductible under current law, the final tax bill expands non-deductible payments to include those paid or incurred to or at the direction of a governmental or specific nongovernmental entity for the violation or potential violation of any law. The provision applies only where a government (or other entity treated in a manner similar to a government under the provision) is a complainant or investigator with respect to the violation or potential violation of any law and does not apply to payments made in a lawsuit between private parties merely because a court ordered the payment. *Exceptions* will exist for those payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, and that are identified in the court order or settlement agreement as restitution, remediation, or required to come

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into compliance as well as amounts paid or incurred as taxes due. This exception does not apply to reimbursement of the government's investigative or litigation costs, which would be nondeductible. *Effective Date:* This provision would be effective for amounts paid or incurred after the date of enactment, not including amounts paid or incurred under any binding order or agreement entered into before such date.