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The Tax Man Cometh – The New Tax Cut and Jobs Act Creates More Questions and Provides Few Answers for Employers

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If an employer finds itself in the unenviable position of being a defendant in a demand letter or complaint, often the decision is made to try and resolve the matter. The new tax act will have a significant impact on that decision. Specifically, IRS code section 162(q) provides:

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.

In the past, an employer had been able to deduct ordinary and necessary expenses incurred in running the business. Generally, this would have included all manner of legal settlements and legal fees. Now, if the settlement agreement has a confidentiality provision, which is “normally” of significant importance to the employer and sometimes the employee, the government will no longer permit the above referenced deductions. However, the new language creates many unanswered questions.

Q: If a claim is made that does not involve sexual harassment or sexual abuse but, as is normally the case, and the release includes language broad enough to include all claims including sexual harassment, would a payment made under this scenario be deductible?

Q: Is the provision only intended to apply to the settlement payments and attorneys' fees or does it apply to other costs incurred in the course of the litigation or a settlement, for example COBRA payments?

Q: The prohibition is very general, therefore are employees/plaintiffs prohibited from deducting the attorneys' fees paid by the employer/defendant?

TAKEAWAY: Currently, the answers are unknown. However, such issues must be considered when any employer is making the decision to enter into a settlement agreement with an employee.

Attorney

- Tracy Armstrong