IRS says #TIMES UP: Companies Can No Longer Keep Sexual Harassment Settlements Confidential

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The #MeToo and #TimesUp movements originated from a desire to shine a bright light on the epidemic of sexual harassment in the workplace. Both the federal government, and more recently the New Jersey Legislature, have weighed in on these movements by passing legislation (in the federal case) and introducing legislation (in New Jersey) designed to penalize or prohibit the practice of requiring victims and alleged victims to sign confidentiality agreements.

Hidden deep within the new federal tax code is a provision aimed at settlement payments in sexual harassment cases. Employers need to be aware of this provision when settling disputes with employees in which they seek a release and confidentiality agreement in exchange for some payment, as doing so may come with tax or other consequences.

Internal Revenue Code Section 162

This section of the Internal Revenue Code generally permits employers to take deductions for ordinary and necessary trade or business expenses paid or incurred during the course of a taxable year. Traditionally, payments to settle disputes, claims or lawsuits, have been tax deductible. However, U.S. Senator Bob Menendez of New Jersey proposed the following change to the tax code, which was passed into law, and is effective beginning with tax year 2018:

(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. 26 *U.S.C.* § 162.

According to Senator Menendez, "Corporations should not be allowed to write-off workplace sexual misconduct as a normal cost of doing business when it is far from normal." (December 21, 2017 Press Release) His stated intention was to "both protect victims of sexual misconduct while ending the practice of taxpayers subsidizing the bad behavior of corporations or executives." (Id.)

As this provision is so new, the Internal Revenue Service has not yet implemented regulations to provide guidance to companies. Instead, questions abound as to the scope and details of this provision. For employers, among those questions is whether this may include settlements for sexual discrimination or bullying claims, as the phrase "related to sexual harassment or sexual abuse" is undefined. Indeed, the terms "sexual harassment" and "sexual abuse" are undefined anywhere in the Internal Revenue Code. Also, of concern is whether this may include severance agreements or settlements that include a full release (not specifically directed to, but theoretically covering any possible claim of sexual harassment) even when there is no basis to believe the employee engaged in or was the victim of sexual harassment or sexual abuse. Employers need to take care anytime they are seeking a full release in exchange for a confidentiality provision.

New Jersey Seemingly Poised To Follow Suit

While not yet a law in New Jersey, in December 2017, Senate Majority Leader Loretta Weinberg introduced a bill in the Senate that would make it unlawful for employers to include a confidentiality provision in an agreement with an employee claiming to be the victim of "harassment, discrimination or retaliation" in the workplace. As drafted, this pending legislation is significantly more broad than that which has been included in the Internal Revenue Code. Whereas the Internal Revenue Code still provides employers a choice (confidentiality vs. tax deductibility) the New Jersey legislation would simply render unlawful any such agreement if it included a non-disclosure or confidentiality provision. Many, including some victim advocacy groups, have been outspoken about the potential harm of such a broad prohibition. Of concern is whether this will impact an employer's willingness to settle claims in an effort to minimize damage to its reputation if the claim were to be made public. Such legislation, if it were to make employers less likely to settle claims for business considerations, could also have an impact on EPLI (employment practices liability insurance) premiums.

Takeaways for Employers

While the full extent of these legislative movements is still unknown, employers should take the time now to review a few items. First, employers should review their standard severance agreements and other separation documents to ensure, as best as possible at this point, that these types of agreements will not subject them to unintended tax consequences. Second, employers should consult with their tax professionals regarding the tax implications of the changes to the Internal Revenue Code. Finally, in the event employers are involved in employment litigation, they should consult with their legal counsel to make a decision on whether to include a confidentiality provision in any settlement agreement and to draft language protecting the company to the fullest extent possible.