New Tax Law Could Have Devastating Consequences for Victims of Sexual Harassment

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NEW TAX LAW COULD HAVE DEVASTATING CONSEQUENCES FOR VICTIMS OF SEXUAL HARASSMENT

By Tanvir H. Rahman

A lesser known amendment buried in the newly-revised federal tax code related to tax deductions businesses may take could very well have devastating, unintended consequences on victims of workplace sexual harassment and abuse. Specifically, §162(q), while originally intended to end a business's ability to deduct sexual misconduct settlements conditioned on non-disclosure agreements (NDAs), states, in its present form, that "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 non-disclosure agreement, or (2) attorneys' fees related to such a settlement or payment."

What this Provision Means

While §162 generally addresses tax deductions which a business may or may not take, many experts have interpreted §162(q) to apply to both businesses *and* individual taxpayers based on its use of the modifier "*under this chapter*." Based upon this reading, victims of workplace sexual misconduct who settle their claims subject to an NDA would be prohibited from deducting the portion of their settlement allocated to attorney fees, but would have to pay taxes on the entire amount of their recovery, and not just the net amount they would ultimately receive. Consequently, victims of workplace sexual misconduct would be worse off than their counterparts who were victims of other forms of invidious discrimination, such as race, age or disability, who can generally deduct settlement portions attributed to attorney fees. As a result of this uncertainty, Sen. Robert Menendez, D-N.J., who is credited with first introducing the idea that businesses should not be allowed to take deductions for sexual harassment settlements conditioned on NDAs, has announced plans to introduce legislation clarifying that §162(q) is meant to apply only to businesses.

Given the increasing influence of the #MeToo movement in recent elections, which is likely to be amplified in this critical mid-term election year, one would think that members of Congress, despite being notoriously slow-moving, will act with urgency to clarify §162(q)'s intent, lest they be accused of further victimizing those who have already been subjected to workplace sexual misconduct.

Myriad Questions Unanswered

However, even assuming that Congress clears up the confusion concerning §162(q)'s reach, there are still myriad unanswered questions surrounding the practical impact §162(q) will have on employment litigation, and how, if at all, the IRS will police this new rule.

For one, it is not uncommon for a plaintiff to accuse an employer of sexual harassment in addition to other forms of workplace discrimination such as race, age or disability bias, or even wage and hour law violations. Unfortunately, Congress has provided no guidance as to how settlements containing NDAs that are meant to resolve all claims in a single case involving multiple theories of liability should be treated. Will an employer be allowed to deduct *any* portion of a settlement that resolves an action in which sexual harassment is alleged, and if so, how much? Should the parties to a confidential settlement be able to weigh the relative strengths and weaknesses of each theory of liability alleged, and apportion a settlement accordingly for purposes of making deductions subject to §162(q)? Is there anything preventing an employer and employee from entering into multiple agreements containing NDAs wherein the bulk of the payout is attributed to non-sexual harassment claims (thus allowing the employer to take a deduction), while a token amount is attributed to sexual harassment claims (thus rendering negligible the impact of §162(q))? And in regards to attorney fees, could an employer deduct any portion of attorney fees incurred where a payout conditioned on an NDA is meant to resolve multiple theories of liability, in addition to sexual misconduct?

Unintended Consequences for Victims

Notwithstanding the countless unresolved questions about how §162(q) will be applied and enforced, the new rule may have additional unintended, negative consequences for victims of workplace sexual misconduct.

For instance, NDAs can act not only as a "shield" for employers guarding against so-called "copycat" claims, but also as a powerful "sword" wielded by an employee who can control whether or not explosive, reputation-tarnishing allegations become public. As such, the notion that an accuser will enter into an NDA is often a driving force behind large settlements paid to victims of sexual misconduct; taking away this weapon could actually drive down the settlement value of such cases. Similarly, employers analyzing settlements from a cost-benefit perspective may be unwilling to offer as much to resolve workplace sexual misconduct allegations knowing that such a payout will not be tax deductible if they want an NDA.

Furthermore, employers who deem an NDA to be "off-the-table" may be less inclined to resolve cases pre-litigation or at an early stage of litigation, and may choose instead to "dig in their heels" and litigate a case to judgment in the hopes that they can clear their names. This arguably further penalizes victims of workplace sexual misconduct by causing them to have to relive traumatic experiences over and over throughout the course of a lengthy and expensive litigation, with no guarantee of success. Of course, on the other hand, some employers who want an NDA may be more inclined to resolve a case early on before their attorney fees escalate given that §162(q) prohibits them from taking a deduction for attorney fees, which would certainly benefit victims of workplace sexual misconduct (perhaps at the expense of defense attorneys).

While Congress deserves some adulation for attempting to think "outside-the-box" and revise the tax

code to punish employers who engage in workplace sexual misconduct, there is much uncertainty and confusion about the real-world, practical implications of §162(q). While only time will tell, it is quite possible that this well-intentioned amendment to the tax code ultimately backfires and leads to unintended, negative consequences to victims of workplace sexual misconduct.

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