

## **Tax Reform Requires Employers to Re-Think their Approach to Settlement Agreements**

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Employers take note: a provision contained in the recently-passed Tax Cuts and Jobs Act of 2017 (the “Act”) now limits tax deductions for certain types of settlement agreements. Specifically, Section 13307 of the Act, styled “Denial Of Deduction For Settlements Subject To Nondisclosure Agreements Paid In Connection With Sexual Harassment Or Sexual Abuse,” (“Section 13307”) prohibits employers from taking income tax deductions for:

1. Any settlement or payment related to sexual harassment or sexual abuse if the settlement or payment is subject to a nondisclosure agreement; or
2. Attorney’s fees related to such settlements.

Previously, when the parties in a dispute involving allegations of sexual harassment or misconduct settled those claims, they agreed to a nondisclosure provision in the settlement agreement. In other words, both parties would be prohibited from disclosing the terms and amount of the settlement (with corresponding penalties resulting from any violation of the provision). The nondisclosure provision did not affect whether any monies paid pursuant to the terms of the settlement agreement were tax-deductible.

Now, however, if a settlement agreement subject to Section 13307 of the Act contains a nondisclosure provision, then the parties to the settlement agreement may not take a tax deduction for the amount of the settlement or any corresponding attorneys’ fees.

Another potential problem that employers may face relates to settlements that resolve multiple claims. Indeed, instances arise where employees and employers settle matters that resolve sexual harassment claims and non-sexual harassment claims in one fell swoop. Section 13307 does not define the terms “related to sexual harassment or sexual abuse” so careful drafting of the settlement agreement and/or ancillary agreements is recommended to maximize opportunities to deduct payments that are not subject to Section 13307. Furthermore, a portion of attorney’s fees attributable to non-Section 13307 claims may also be deductible.

Stated simply, the scope and breadth of Section 13307 remains murky, and it will take time before clear answers to the above-listed questions emerge. Thus, employers defending against allegations of misconduct covered by Section 13307 would do well to discuss the implications of settling such

claims with competent counsel.

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