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Major Legislative Changes in Sexual Harassment: Tax Repercussions and the Enforceability of Non-Disclosure Provisions and Mandatory Arbitration Agreements

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The #MeToo and #TimesUp movements have created a national dialogue about the prevalence of sexual harassment in the workplace, and legislators are responding with new legislation aimed at preventing the secret settlement or arbitration of claims.

Federal Tax Overhaul Limits Deductions in Sexual Harassment Settlements

In an effort to promote greater transparency, national and state legislatures are trying to restrict the use of non-disclosure provisions in settlement agreements for sexual harassment allegations.

Non-disclosure provisions are routinely included in employment, settlement and severance agreements. Typically, they contain promises by one or both parties that the terms or even the existence of the agreement will be kept private. These provisions have recently come under fire by victims' rights advocates who argue such clauses silence victims and enable serial harassers to continue their predatory behavior.

The Tax Cuts and Jobs Act of 2017 prohibits employers from deducting settlement payouts and related attorneys' fees for sexual harassment claims, if the settlement agreement contains a non-disclosure provision. Prior to the enactment, employers were permitted to deduct these payments as a business expense. Moreover, Congress also prohibited employers from deducting settlement payments from sexual harassment and other workplace claims which were made "at the direction" of government entities, such as the EEOC.

State Legislators Tackle Non-Disclosure Clauses

State legislatures are also introducing bills intended to further limit the use of non-disclosure clauses in settlement agreements, and in some cases prohibit their use altogether. California, New York,

Pennsylvania and New Jersey have all proposed legislation that would invalidate any non-disclosure provision in a settlement agreement for claims of sexual harassment. Additionally, advocates in Florida, Delaware, Indiana, New York, North Carolina, Oregon and Washington have argued state Sunshine Laws prohibit the use of non-disclosure clauses in settlement agreements. These laws prohibit court orders or settlements from including non-disclosure agreements if their purpose is to conceal a public hazard. Supporters of these measures argue serial harassers pose a public hazard and should be included in the scope of these laws.

Mandatory Arbitration Agreements

Mandatory arbitration agreements are also under review due to the lack of transparency in arbitration proceedings. In December 2017, the Ending Forced Arbitration of Sexual Harassment Act of 2017 was introduced with bipartisan support in the Senate. This legislation would significantly amend the Federal Arbitration Act by invalidating any pre-dispute arbitration agreement that covers sexual harassment claims as defined under Title VII. The bill is currently under consideration by the Senate Committee on Health, Education, Labor and Pensions.

In light of the recent legislative acts, employers should re-evaluate their strategies addressing sexual harassment claims. Employers should weigh the risks of including these provisions in settlement agreements by considering:

1. Whether non-disclosure provisions are valid under applicable state law;
2. Whether the risk associated with an employee’s disclosure of settlement terms is greater than the cost of the tax penalty;
3. The risk of using such provisions in settlements that include sexual harassment as well as other employment claims; and
4. Whether an EEOC directed settlement of any workplace claim will be tax deductible.

In light of their recent scrutiny, employers who decide against the use of non-disclosure provisions should continue to include narrowly tailored non-disparagement and non-admission provisions that make clear the employer has not admitted to liability by entering into the settlement. Employers should also reconsider the scope of their pre-dispute arbitration agreements.

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