

IRS Clarifies TCJA's Sexual Harassment Provision

by Kristen A. Parillo

The IRS clarified that sexual harassment victims who have signed a settlement deal subject to a nondisclosure agreement won't be barred from deducting their legal fees.

The IRS made its view known in an FAQ posted to its website February 28, resolving uncertainty on whether a Tax Cuts and Jobs Act provision intended to prevent employers from deducting "hush money" settlements would also limit the deductibility of victims' attorney fees.

The question posed in the FAQ is whether section 162(q) precludes a person from deducting attorney fees related to the settlement of a sexual harassment claim if the settlement is subject to a nondisclosure agreement.

The IRS responded, "No, recipients of settlements or payments related to sexual harassment or sexual abuse, whose settlement or payment is subject to a nondisclosure agreement, are not precluded by section 162(q) from deducting attorney's fees related to the settlement or payment, if otherwise deductible."

The IRS's acknowledgment that fees paid to an attorney by a sexual harassment or abuse victim will be deductible by the victim "should be welcome news to harassment victims," Marvin A. Kirsner of Greenberg Traurig LLP told *Tax Notes*.

Unintended Meaning

Kirsner said that section 162(q) was worded so broadly that it appeared to disallow the deduction, "resulting in a tax burden to the victims that was likely never envisioned by Congress."

Dubbed the "Weinstein tax" in reference to film producer and alleged serial harasser Harvey Weinstein, section 162(q) denies a deduction for "any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement," as well as "attorney's fees related to such a settlement or payment."

Soon after the TCJA was enacted, observers pointed out that the wording might have created an unintended result. Because section 162(q) states that no deduction is allowed "under this

chapter," observers said the new law could be read to apply to all of chapter 1 of the tax code, which covers businesses and individuals. Thus, the provision could prohibit the recipient of the settlement deal from deducting attorney fees.

Kirsner noted that the IRS FAQ came after the Joint Committee on Taxation published its explanation of the TCJA in December 2018 (JCS-1-18), stating that attorney fees incurred by the beneficiary of a settlement aren't subject to the rule.

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Regarding whether the IRS can clarify the application of section 162(q) without Congress formally approving legislation to do so, Robert W. Wood of Wood LLP said, "In my view, the IRS can absolutely do this, and it is wonderful that they did."

"I don't know, from a statutory perspective, if the fact that Congress identified the issue but has failed to correct it so far somehow undercuts the IRS," said Wood, who has written in *Tax Notes* about the ramifications of section 162(q). "But I cannot imagine anyone complaining. There was a lot of worry about plaintiffs not being able to deduct their fees, and I was getting a large number of queries about it."

Congressional Intent

Senate Finance Committee member Robert Menendez, D-N.J., who introduced the amendment that ultimately became section 162(q) during a markup of the Republican tax bill, said in a December 2017 release that Republicans had altered the legislative language in the final version of the bill, resulting in unintended consequences for victims.

Menendez said his amendment targeted business — not individual — tax deductions and was intended to "protect victims of sexual misconduct while ending the practice of taxpayers subsidizing the bad behavior of corporations or executives."

Republican taxwriters erroneously included the phrase “this chapter” in their bill, Menendez said. In May 2018 Menendez introduced the Repeal the Trump Tax Hike on Victims of Sexual Harassment Act of 2018 (S. 2820) to clarify that section 162(q) doesn’t affect the deductibility of victims’ attorney fees, but the bill didn’t advance.

On January 2, his last day as chair of the House Ways and Means Committee, Rep. Kevin Brady, R-Texas, introduced a discussion draft of the Tax Technical and Clerical Corrections Act that proposed fixes to provisions in the TCJA and other tax laws. The draft suggested amending section 162(q) by inserting “in the case of the taxpayer for whom a deduction is disallowed by reason of paragraph (1),” before “attorney’s fees.”

In its technical explanation (JCX-1-19) of the discussion draft, also released January 2, the JCT said that section 162(q) “could be read to prohibit both defendants and plaintiffs from deducting attorneys’ fees related to a settlement or payment relating to a claim of sexual harassment or sexual abuse that is subject to a nondisclosure agreement.”

The JCT said the proposed technical correction would clarify that section 162(q) doesn’t apply to plaintiffs and therefore doesn’t affect the deductibility of plaintiffs’ attorney fees. ■