


FEBRUARY 16, 2018 | REGULATORY & GOVERNMENT OVERSIGHT

Taxing Decisions: New Rules on Deductions and Credits in the Employment Context

By: [Aaron Gelb](#)

As many individuals turn their attention to preparing and filing their tax returns on or before April 15, there are  two notable changes to the tax code of which employers should take note. These changes, tucked away in the 2017 Tax Act (also known as the Tax Cuts and Jobs Act) (the "Act"), have gone largely unnoticed while most Americans have focused on the on-again, off-again government shutdown drama. The first change involves the deductibility of settlement payments made to resolve sexual harassment/abuse claims, while the second is a tax credit available, in certain circumstances, to employers that offer paid family leave to their employees.

Sexual Harassment and/or Abuse Settlement Payments

Section 13307 of the Act prohibits employers from deducting any settlement or payment related to sexual harassment or abuse claims if the settlement or payment is made subject to the sort of nondisclosure provisions commonplace in settlement agreements. This means that if an employer insists that the complaining employee keep the terms of the agreement confidential, the monies paid in exchange for the release are not deductible. The same presumably holds true if the employer conditions said payments on the claimant agreeing not to disclose the allegations set forth in the original claim that precipitated the settlement.

If, however, the employer does not include a confidentiality provision in the agreement, the settlement payment can be deducted. Employers must thus decide which is more important—the tax savings associated with the deduction or the silence that accompanies the nondisclosure provision. Given the reputational harm and public relations challenges associated with claims of sexual harassment and/or abuse, most employers will likely forego tax relief in exchange for confidentiality.

At the same time, this provision prohibits the deduction of attorney's fees tied to confidential payments. It is unclear, at present, whether this prohibition applies to fees paid only by the employer or also precludes the claimant from deducting the fees he or she incurred. If that is the case, employers should expect claimants and their attorneys to strenuously insist that the agreement not include a confidentiality provision.

Also unclear is what happens when the settlement encompasses other claims—such as age, race or disability discrimination, for example—in addition to the sexual harassment and/or abuse allegations. Will employers be unable to claim a deduction for payments relating to such claims if they are resolved in the same agreement as

sex harassment and/or abuse claims? We can assume that retaliation claims relating to the underlying harassment and/or abuse claims will be similarly exempt from the non-disclosure terms given the purpose of the Section. While employers may attempt to employ creative drafting strategies such as assigning a nominal amount of the monies paid to the harassment and/or abuse claims so they can deduct the remainder, such an approach will likely draw scrutiny. Alternatively, employers may simply include a carve out provision in the confidentiality section stating that it applies to the other claims but not the harassment and/or abuse claims.

Whatever approach an employer decides to pursue, these are issues that should be discussed and decisions that should be made before beginning a mediation or settlement conference.

Paid Family Leave Tax Credits

While employers stand to lose the ability to deduct payments tied to sexual harassment and/or abuse claims, they now have the ability—in limited circumstances—to claim a tax credit if they decide to provide paid family and medical leave to their employees beginning in 2018. Employers that meet certain eligibility requirements will be able to claim a general business credit equal to a percentage of wages paid to qualifying employees on leave under the Family and Medical Leave Act (FMLA).

To receive the credit, an employer must provide at least two weeks of leave and compensate their workers at a minimum of 50 percent of their regular earnings. The tax credit will range from 12.5 percent to 25 percent of the cost of each hour of paid leave, depending on how much of a worker's regular earnings the benefit replaces. The government, meanwhile, will kick in 12.5 percent of the cost of the paid leave if workers receive half of their regular earnings. This contribution will increase as high as 25 percent if workers receive their entire regular earnings.

The tax credit, however, will apply only to paid leave offered to employees earning less than \$72,000 per year. Additionally, employers seeking to claim the credit must offer paid leave to part-time employees as well as those who work full-time. Part-time employees must be permitted to take a commensurate amount of paid leave, determined on a pro-rata basis, compared to the full-time employees.