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"Me, Too" Taxed Too?

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In the fall of 2017, the "Tax Cuts and Jobs Act of 2017" slid through Congress, was signed into law by the president on December 22, and took effect on January 1, 2018.

Also during that fall, the "Me, Too!" movement was sweeping the globe. On October 15, 2017, actress Alyssa Milano tweeted, "If you've been sexually harassed or assaulted, write 'me too' as a reply to this tweet." The hashtag "MeToo" was tweeted by hundreds of thousands, and CBS News reported that there were 12 million Facebook "Me, Too" posts within only 24 hours.

Commentators said that a significant reason for the ability of powerful media-men-sexual assaulters to repeat their crimes — many of which happened over decades — was that they and their employers "paid off" victims with settlement funds tied to non-disclosure provisions like: "If you tell anyone about the underlying alleged facts, or that there is a settlement agreement, or that you were paid money, you will have to pay us back and pay our attorney fees."

Non-Disclosure Agreements, a/k/a "NDAs," a/k/a "confidentiality provisions," had allowed serial rapists and harassers to commit their crimes again and again, aided by their corporate insurance, corporate counsel, and boards of directors who "saw not, heard not, knew not, and spoke not," but covered up a lot.

Members of Congress were aware of "Me, Too" while the "Tax Cut Bill of the Century" moved along towards the president's desk (moving mostly behind closed doors; there were no hearings, just votes). So, in November 2017, just a few weeks before the bill landed on Old Resolute, Senator Menendez, (D-N.J.), proposed using the tax law to sanction sexual harassers and their employers who included NDA's into settlement agreements. How? With tax penalties that disallowed business deductions for settlement funds and attorney fees paid by them.

It sounded good! (Although meaningless when insurance pays the settlement and provides attorneys.)

So, imagine Senator Menendez's ire when his idea, his tax proposal, applauded by colleagues on both sides of the aisle, *ended up with language drafted by (Republican) staffers that harmed sexual harassment victims!* How could this be? The wording started out OK:

"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 nondisclosure agreement …"

So far, so good, right? But then the drafters, either careless, clueless or backstabbing, wrote:

"or

(2) attorney fees ***related to such settlement or payment****."* (emphasis added)

The drafters failed to limit the sanction to the harassers and their employers. Thus, victims, whose attorney fees were paid under such settlement agreements could no longer deduct them in the tax wash of 2004; this would always significantly reduce a victim's recovery.

1996 Redux?

Prior to 1996, both physical and emotional damages were tax-free "personal injury damages." But, in 1996, House Speaker Newt Gingrich championed a bill which eliminated the tax-free status of emotional distress damages, unless they emanated from physical injury (basically, blood and/or bruises). The commentary was that Gingrich's motivation was to stop Democrat-supporting trial attorneys from attributing all damages to emotional distress, rather than for lost pay, as a means for both parties to avoid payroll taxes.).

PTSD because you broke a leg in a car accident? Tax free emotional distress damages.

PTSD because your boss leaned on you while groping under your blouse? Tax *that* emotional distress (no blood, no bruises).

This worked terrible hardships on victims of employment discrimination, because statutory attorney fees were not incurred as the result of any physical injury. *The day before* the 1996 law went into an effect, a $100,000 sexual harassment emotional distress settlement with no wage claim and a 1/3 attorney fee agreement meant the lawyer would pay taxes on her $33,333 and the client would pay zero taxes on the $66,666 emotional distress damages. *The day after* the 1996 tax law went into effect, the lawyer again paid taxes on the $33,333 fees, but now the client was taxed on the full $100,000, with the $33,333 attorney fees being double taxed, as a result.

Years of lobbying by civil rights advocates to fix this problem were assisted by a New York Times article about a Cook County, Illinois employee who successfully sued her agency for gender discrimination. The jury awarded her $3 million, which the judge cut to the statutory Title VII cap of $300,000, then awarded her $850,000 in attorney fees and $100,000 in expenses.

She would not celebrate, because now she owed Uncle Sam so much money that she suffered a net loss of $99,000 for the privilege of winning her case. Under IRS interpretation, such employees were limited to a "below the line" deduction for attorney fees paid in their cases, leaving most plaintiffs with no fee deduction, and others in debt to the IRS.

The 1996 tax mistake was fixed when President Bush signed the "American Jobs Creation Act of 2004." Attorneys could again represent employees whose damages or wage claims were modest compared to the statutory fees, and employees could deduct 100 percent of their attorney fees paid in settlement or at trial as an "above the line deduction."

But, like the shark in "Jaws," for sexual harassment victims with non-disclosure settlements, the tax shafting of discrimination victims is b-a-a-a-a-a-ck under the 2017 tax act. Senator Menendez tried to get the problem fixed. In May, 2018 he filed the "Repeal the Trump Tax Hike on Victims of Sexual Harassment Act of 2018." It went nowhere. Few Republicans expressed interest as the fall election loomed, and even sympathetic Democrats were reluctant to amend the tax bill for which none of them had voted.

Likely, a more "woke" Congress will fix the problem. Until then, enhanced settlement amounts, creative percentage attributions, and indemnification provisions are used to convince some sexual harassment victims to agree to NDA's, even as uninsured defendants can rationally risk public litigation rather than automatically lose deductions for payments and fees under a confidential settlement.

Nancy Richards-Stower has an office in Merrimack and has advocated for employee rights since 1976. She will be a presenter at the NHBA's 18th Annual Labor and Employment Law Update on Thursday, April 11. For more information, visit https://www.nhbar.org/nhbacle/.