



November 20, 2019

Mr. John Moriarty
Associate Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Section 162(q) – Payments Related to Sexual Harassment and Sexual Abuse

Dear Mr. Moriarty:

The American Institute of CPAs (AICPA) respectfully submits comments to the Department of the Treasury (“Treasury”) and Internal Revenue Service (IRS) regarding payments related to sexual harassment and sexual abuse under Internal Revenue Code section 162(q)¹ as enacted under Public Law No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA). The AICPA understands and agrees with the public policy and intent behind section 162(q). We are commenting from the perspective that clarification of wording is important for equity purposes to ensure that all taxpayers subject to this disallowance rule will apply it consistently.

The AICPA recommends that Treasury and IRS issue proposed regulations to provide necessary clarification for taxpayers, governments, and nongovernmental entities subject to the requirements of section 162(q). Specifically, we recommend that Treasury and IRS issue guidance clarifying:

- I. What constitutes “sexual harassment or sexual abuse” for purposes of section 162(q);
- II. Whether disallowance of a deduction under section 162(q) applies to amounts paid to persons other than the claimant alleging sexual harassment or sexual abuse;
- III. The tax treatment of a settlement, payment or attorney’s fee related both to sexual harassment or sexual abuse and to additional claims;
- IV. Whether settlements or payments are related to sexual harassment or sexual abuse where such matters are within the scope of the documentation of the settlement or

¹ Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.

payment, however, no allegation of sexual harassment or sexual abuse was made or investigated prior to the settlement or payment;

- V. Whether a “nondisclosure agreement” includes the existence or assertion of attorney-client privilege with respect to the investigation of allegations of sexual abuse or sexual harassment or the representation of clients with respect to such allegations; and
- VI. Whether the disallowance of attorney’s fees applies to amounts paid by the party receiving the payment or settlement.

The AICPA is the world’s largest member association representing the accounting profession, with more than 429,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to discuss our comments. If you have any questions, please contact Connie Cunningham, Chair – AICPA Tax Methods and Periods Technical Resource Panel, at 310-557-8544, or cccunningham@bdo.com; Grant Anderson – AICPA Tax Methods and Periods Technical Resource Panel, at 202-222-2035, or grantanderson@deloitte.com; Elizabeth Young, Senior Manager – AICPA Tax Policy & Advocacy, at 202-434-9247, or elizabeth.young@aicpa-cima.com; or me at (612)-397-3071 or chris.hesse@CLAconnect.com.

Sincerely,



Christopher Hesse, CPA
Chair, AICPA Tax Executive Committee

- Cc: Ms. Ellen Martin, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Ms. Wendy Friese, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Mr. Christopher Wrobel, Special Counsel, Office of the Associate Chief Counsel, (Income Tax & Accounting), Internal Revenue Service

AMERICAN INSTITUTE OF CPAs

Comments on Section 162(q)

November 20, 2019

General Background

Section 162(a) allows a taxpayer a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.² The general rule of section 162(a) is subject to various exceptions and qualifications. For example, no deduction is allowed for charitable contributions and gifts,³ illegal bribes, kickbacks, and other payments,⁴ certain lobbying and political expenditures,⁵ and certain fines or similar penalties paid to a government for the violation of any law.⁶

Section 62(a)(20) generally provides individual taxpayers with a deduction for attorney's fees and court costs paid by, or on behalf of, the taxpayer in connection with any action involving a claim of unlawful discrimination as defined by section 62(e). In other situations, attorney's fees and court costs may be an expense paid or incurred for the production or collection of income under section 212(1) and may be deductible subject to the limitations of section 67. See generally *Commissioner v. Banks*, 543 U.S. 426 (2005).

The TCJA enacted section 162(q), which provides that “[n]o deduction shall be allowed under this chapter for certain amounts related to sexual harassment and sexual abuse.” The reference to Chapter 1 of Title 26 indicates that the disallowance is not limited to deductions for trade or business expenses under section 162. Section 162(q) is effective for amounts paid or incurred after December 22, 2017.⁷

Section 162(q)(1) provides that no deduction is allowed for any settlement or payment related to sexual harassment or sexual abuse if the settlement or payment is subject to a nondisclosure agreement. This provision does not define “sexual harassment” or “sexual abuse” and does not describe the circumstances in which a settlement or payment is “related to” such acts.

Section 162(q)(2) provides that no deduction is allowed for amounts paid or incurred for attorney's fees related to a settlement or payment described in section 162(q)(1). The provision does not describe the circumstances in which attorney's fees are “related to” a settlement or payment relating to sexual harassment or sexual abuse.

The General Explanation of the TCJA prepared by the Joint Committee on Taxation states that under section 162(q), “no deduction is allowed for any settlement or payment related to sexual

² Section 162(a).

³ See section 162(b) (explaining there is no section 162 deduction for charitable contributions and gifts for which section 170 provides a deduction).

⁴ Section 162(c).

⁵ Section 162(e).

⁶ Section 162(f).

⁷ See P.L. 115-97 section 13307(a).

harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement. In addition, in the case of the taxpayer for whom a deduction is disallowed, no deduction is allowed for attorney's fees related to such settlement or payment. Any attorney's fees incurred by the beneficiary of the settlement or recipient of the payment are not subject to this rule."⁸ In a footnote to the final sentence, the Joint Committee states that "[a] technical correction may be necessary to reflect this intent."

Specific Comments

Further guidance in the form of proposed regulations or otherwise should include the following issues that require clarification to reduce the burden on taxpayers, governments, and nongovernmental entities subject to the requirements of section 162(q), and on the IRS during examinations:

I. What constitutes "sexual harassment or sexual abuse" for purposes of section 162(q)

Overview

Section 162(q)(1) disallows deductions for settlements, payments or attorney's fees that are "related to sexual harassment or sexual abuse" and are subject to a nondisclosure agreement. The terms "sexual harassment" and "sexual abuse" are not defined with section 162(q).

Recommendation

The AICPA recommends that Treasury and IRS provide guidance on the conditions or conduct that constitute "sexual harassment" and "sexual abuse" for purposes of section 162(q).

Analysis

The terms "sexual abuse" and "sexual harassment" are not defined for purposes section 162(q). Section 162(q) applies broadly to settlements and payments; therefore, there will typically be no formal adjudication or determination addressing the characterization of the conduct under a particular legal standard or definition. Without further guidance, it may often be unclear whether particular conditions or conduct to which a settlement or payment are related, constitute sexual harassment or sexual abuse within the scope of these terms for purposes of section 162(q).

II. Whether disallowance of a deduction under section 162(q) applies to amounts paid to persons other than the claimant

Overview

Section 162(q)(1) provides that no deduction is allowed for any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement. The provision is not expressly limited to amounts paid to persons asserting claims relating to the sexual harassment or sexual abuse.

⁸ Joint Committee on Taxation, General Explanation of Public Law 115-97 at 195 (December 2018).

Recommendation

Treasury and IRS should issue guidance clarifying whether section 162(q)(1) is limited to persons asserting claims related to the sexual harassment or sexual abuse. The AICPA recommends restricting the disallowance to amounts paid to the claimant(s). See our comments below regarding payments to attorneys for the claimant(s).

Analysis

When sexual abuse or sexual harassment is alleged, a taxpayer may incur a variety of costs in responding to the allegation. The taxpayer may use employees to screen and evaluate claims, for example, or hire third party professionals to represent the taxpayer in negotiation, arbitration or litigation. Generally, payments made to these parties are smaller in amount and may be difficult to trace to specific non-deductible settlements, particularly with respect to employee costs that relate to a multitude of activities. If such payments were included within the scope of section 162(q)(1), taxpayers could face substantial administrative burdens and uncertainty in performing the necessary analysis to identify all non-claimant costs relating to sexual harassment or sexual abuse.

The language of section 162(q)(1) does not restrict the disallowance of deductions to payments made to the party alleging sexual harassment or sexual abuse. Accordingly, section 162(q)(1) could arguably disallow deductions for amounts paid to employees or contractors for services performed in connection with the allegations of sexual harassment or sexual abuse (if there is a nondisclosure agreement with respect to such matters). Treasury and IRS should provide guidance clarifying that section 162(q)(1) is limited to payments to persons asserting claims related to the sexual harassment or sexual abuse to avoid imposing additional administrative burden on taxpayers.

III. The tax treatment of a settlement, payment or attorney's fee related both to sexual harassment or sexual abuse and to additional claims

Overview

Section 162(q)(1) provides that no deduction is allowed for any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, and section 162(q)(2) provides that no deduction is allowed for attorney's fee related to such settlement or payment. The statute provides no express guidance for situations where the settlement, payment or attorney's fee relates both to sexual harassment or sexual abuse and to claims other than sexual harassment or sexual abuse.

Recommendation

The AICPA recommends that Treasury and IRS furnish guidance allowing taxpayers to allocate settlements, payments and attorney's fees between amounts related to sexual harassment or sexual abuse and amounts related to other matters and providing that the disallowance of settlements,

payments and attorney's fees under section 162(q) applies only to amounts related to sexual harassment or sexual abuse.

Analysis

In many situations, a payment or settlement is made to resolve multiple claims, some of which are related to sexual harassment or sexual abuse and some of which are related to other matters. As a further complication, a payment or settlement may be a net amount reflecting the resolution of counterclaims asserted against the party receiving the settlement or payment. Section 162(q) does not expressly address such situations, but it provides that the disallowance of the deduction applies to settlements, payments and attorney's fees "related to" sexual abuse and sexual harassment. This language implies that settlements, payments and attorney's fees that relate to multiple claims should be allocated on some reasonable basis between amounts related to sexual abuse and sexual harassment (which are subject to disallowance if subject to a nondisclosure agreement) and amounts related to other matters (which are not subject to section 162(q)).

The government has historically allowed taxpayers to allocate a payment to the extent it relates to more than one claim/statute in the context of pre-TCJA section 162(f) under the general rules of the origin-of-the-claim test. For instance, in FSA 200146008, the IRS noted that in the event that litigation or settlement involves more than one claim, a taxpayer must determine the amount allocable to each and then evaluate the nature and character of each claim to determine the proper tax consequences.

IV. Whether settlements or payments are related to sexual harassment or sexual abuse where such matters are within the scope of the documentation of the settlement or payment, however, no allegation of sexual harassment or sexual abuse was made or investigated prior to the settlement or payment

Overview

Section 162(q)(1) provides that no deduction is allowed for any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement. The statute does not address whether a settlement or payment is related to sexual harassment or sexual abuse where sexual harassment or sexual abuse are within the terms of the settlement or payment documentation, but no allegation of sexual harassment or sexual abuse was made or investigated prior to the settlement or payment.

Recommendation

The AICPA recommends that Treasury and IRS provide guidance that a settlement or payment is not related to sexual harassment or sexual abuse where sexual harassment or sexual abuse falls within the scope of the settlement or payment documentation, but sexual harassment or sexual abuse was not alleged or investigated prior to the settlement or payment.

Analysis

The documentation executed in dispute resolutions often describes the settlement or payment as resolving a broad range of issues. For example, a severance agreement for an executive alleging age discrimination by an employer may purport to resolve ‘all claims resulting from employment’ or may enumerate a long list of possible claims other than age discrimination. Such broad language may include claims that have never been actively alleged or investigated prior to the settlement or payment and are included solely as a matter of course to resolve as many potential issues as possible.

Section 162(q)(1) denies a deduction for a settlement or payment that is “related to” sexual abuse or sexual harassment and is subject to a nondisclosure agreement. If the settlement or payment documentation is written broadly and includes sexual abuse or sexual harassment within its terms, the settlement or payment could arguably be “related to” sexual abuse or sexual harassment even if there has been no assertion or investigation of such matters. Such a result is contrary to the apparent intent of section 162(q) to apply to settlements or payments related to allegations of sexual harassment or sexual abuse that were made before the settlement or payment.

V. Whether a “nondisclosure agreement” includes the existence or assertion of attorney-client privilege with respect to the investigation of allegations of sexual abuse or sexual harassment or the representation of clients with respect to such allegations

Overview

Section 162(q)(1) provides that no deduction is allowed for any settlement or payment related to sexual abuse or sexual harassment if such settlement or payment is subject to a nondisclosure agreement.

Recommendation

The AICPA recommends that Treasury and IRS clarify that the existence or assertion of attorney-client privilege by an attorney with respect to the investigation of sexual harassment or sexual abuse, or the representation of clients with respect to such matters, is not a nondisclosure agreement for purposes of section 162(q). This clarification should also apply to other professionals such as doctors and psychologists who are subject to legal or professional requirements of confidentiality.

Analysis

When allegations of sexual abuse or sexual harassment are raised, professionals such as doctors, attorneys and psychologists may become involved to investigate the allegations, provide treatment or professional consultations, or represent parties in negotiation, mediation or litigation. Confidentiality is a normal and necessary part of such professional activities and treating such confidentiality as a reason for denying a deduction under section 162(q) would discourage the use of these professionals whose involvement facilitates better resolutions and helps to ensure that parties receive due process of law.

VI. Whether the disallowance of attorney’s fees applies to amounts paid by the party receiving the settlement or payment

Overview

Section 162(q)(2) provides that no deduction shall be allowed for attorney’s fees related to a settlement or payment related to sexual abuse or sexual harassment if such settlement or payment is subject to a nondisclosure agreement.

Recommendation

The IRS has issued informal guidance on its website indicating that the disallowance of attorney fee deductions under section 162(q)(2) does not apply to amounts paid by the recipients of settlements or payments related to sexual abuse or sexual harassment. The AICPA recommends that Treasury and IRS issue formal guidance (e.g., proposed regulations) addressing this issue to provide taxpayers with additional certainty.

Analysis

The General Explanation of the TCJA prepared by the Joint Committee on Taxation, states that under section 162(q), “no deduction is allowed for any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement.” In addition, in the case of the taxpayer for whom a deduction is disallowed, no deduction is allowed for attorney’s fees related to such settlement or payment. Any attorney’s fees incurred by the beneficiary of the settlement or recipient of the payment are not subject to this rule.”⁹ In a footnote to the final sentence, the Joint Committee states that “[a] technical correction may be necessary to reflect this intent.”

On January 2, 2019, Representative Kevin Brady (R-Texas) introduced a discussion draft of the Tax Technical and Clerical Correction Act that proposed fixes to provisions in the TCJA and other tax laws.¹⁰ The draft suggests amending section 162(q)(2) by inserting “in the case of the taxpayer for whom a deduction is disallowed by reason of paragraph (1)” before “attorney’s fees.”¹¹ In its technical explanation of the discussion draft, the Joint Committee on Taxation stated that section 162(q) “could be read to prohibit both defendants and plaintiffs from deducting attorney’s 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 Joint Committee on Taxation further observed that the proposed language in the discussion draft “clarifies that section 162(q) does not apply to plaintiffs, and therefore does not affect the deductibility of plaintiffs’ attorney’s fees.”¹²

⁹ Joint Committee on Taxation, General Explanation of Public Law 115-97 at 195 (December 2018).

¹⁰ Joint Committee on Taxation, House Ways and Means Committee Chairman’s Discussion Draft of the Tax Technical and Clerical Corrections Act (January 2, 2019).

¹¹ Id. at section 4(r).

¹² Joint Committee on Taxation, Technical Explanation of the House Ways and Means Committee Chairman’s Discussion Draft of the Tax Technical and Clerical Corrections Act (JCX-1-19) at 9 (January 2, 2019).

On February 28, 2019, the IRS released on its website a FAQ stating its view of the application of section 162(q) to attorney's fees.¹³ In response to the question of whether section 162(q) prohibited a taxpayer from deducting attorney's fees related to the settlement of a sexual harassment claim if the settlement was subject to a nondisclosure agreement, the FAQ states "[n]o, 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."

¹³ IRS, "[Section 162 FAQ](#)."