Disclosure vs. deduction: Uncle Sam speaks on silencing sexual harassment settlements

Section 162(q) of the recently enacted tax code shifts the focus of tax policies.

Sexual harassment in the workplace has recently become a point of national focus. While high-profile cases have dominated headlines, this is an issue that has touched myriad industries and individuals at all levels. Sexual harassment may occur in the office or offsite (e.g., at a holiday party or during business travel) among employees, contractors or third parties (e.g., potential or actual clients). Companies should, as explained further below, take certain proactive measures to reduce the risk of sexual harassment as well as respond in a measured, thorough and prompt manner when sexual harassment allegations arise.

Generally, under federal law, sexual harassment is unwelcome conduct of a sexual nature that: (i) may materially impact an individual's employment or job performance or (ii) create an intimidating, hostile or offensive working environment. (29 C.F.R. § 1604.11 (2018)) State and local laws may vary and provide additional protections.

Previously, there were no disclosure-related restrictions on a company's ability to deduct sexual harassment settlements and related attorney fees. However, this changed with the recent passage of a new tax code provision, Section 162(q) of the Internal Revenue Code (Section 162(q)), effective December 22, 2017. (26 U.S.C. § 162(q) (2018)). Generally, if a settlement/payment relates to sexual harassment or sexual abuse, and that settlement/payment is subject to a non-disclosure agreement, then Section 162(q) prohibits an employer from deducting that settlement/payment and the related attorney fees as a business expense. (26 U.S.C. § 162(q) (2018))

Section 162(q) is notable because it marks a fundamental shift in tax policy regarding workplace sexual harassment. Silence costs. Transparency is now tax-favored. In that regard, companies will now pay more (via the loss of tax deductions) for sexual harassment settlements that are subject to non-disclosure provisions. The intent of the law is to deter confidentiality provisions, even amidst employers' potential countervailing business considerations (e.g., avoiding adverse public relations, disclosing a claim's financial impact, providing a benchmark valuation for future claims). In addition to hopefully encouraging more victims of sexual harassment to step forward, increased transparency (and awareness) may also incentivize employers to proactively reduce their risk regarding sexual harassment in the workplace. After all, as the adage cautions, reputations are hard to build and easy to damage.

With this aim of reducing an organization's exposure as it relates to sexual harassment claims (as well as other claims which may arise under employment practice liability insurance), here are five steps an organization can take today:

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1. **Training:** It is vital that employers provide training on the prevention of sexual harassment, discrimination (Generally, under Title VII of the Civil Rights Act of 1964, it is unlawful for an employer to discriminate or "to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin..." 42 U.S.C. § 2000e-2(a)(1) (2018). Additional protected characteristics under federal law include age, disability, pregnancy, military service, citizenship status, genetic information, whistleblowing and taking family medical leave. State and local laws may vary and provide additional protections, including protections based on sexual orientation, marital status and domestic victim violence status.) and retaliation (Generally, retaliation occurs when an employer discriminates "against any of his employees or applicants for employment... because he has opposed any practice made an unlawful employment practice by this subchapter, or because he has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under this subchapter." 42 U.S.C. § 2000e-3(a) (2018).) in the workplace. Training should be done regularly

(e.g., every year), and to the extent feasible, in person (as opposed to virtual meetings). Attendance should be recorded and new employees with supervisory authority should be trained within six months of hiring; heightened liability may apply to an employer if the alleged harasser is in a management or supervisory capacity (as opposed to instances in which the alleged harasser and victim are co-workers). (*Vance v. Ball State Univ.*, 133 S. Ct. 2434, 2443 (2013) (holding "that an employer may be vicariously liable for an employee's unlawful harassment only when the employer has empowered that employee to take tangible employment actions against the victim ...").) In addition to providing a fundamental overview of the applicable legal parameters, trainings should discuss an employer's policies, reporting requirements and processes, as well as internal (or external) personnel who are available to assist with complaints. At a minimum, employers should ensure that their training programs comply with local law; for example, in addition to covering sexual harassment prevention, generally, California law requires that large employers provide training on preventing abusive conduct or bullying. (Cal. Gov't Code § 12950.1(b) (2018).)

2. Handbooks, manuals and policies: A company's handbook, manuals and policies should reflect a workplace culture that is inclusive and welcomes diversity. In particular, these policies should clearly explain and prohibit sexual harassment, discrimination and retaliation. Reporting obligations, confidentiality provisions, training requirements, investigation procedures and consequences (including termination) should also be plainly stated. Legal counsel should review these materials to ensure compliance with applicable laws. Further, employees should be required to provide written acknowledgement of receipt of these materials on an annual basis. From a legal perspective, if a litigation or formal agency complaint arises, these materials may provide evidence of the company's reasonable efforts to create a working environment that does not tolerate sexual harassment.

3. Investigations: Claims of sexual harassment should be investigated immediately, thoroughly and fairly. If impartiality is an issue, consider a third-party investigator, such as a law firm or a human resource consulting agency. Objectivity should be well-documented (e.g., interview scripts, interview summaries and internal memoranda regarding business decisions), and if applicable, reasonable steps should be taken to maintain attorney-client privilege.

In today's digital world, employers may feel pressure to respond quickly and publicly to sexual harassment allegations. As a matter of best practice, companies should promptly assemble a cross-functional working group, which, at a minimum, should include internal and, if necessary, external Legal Counsel, Human Resources and Communications, to craft and deliver risk-sensitive responses as part of a larger (crisis) public relations strategy that preserves the integrity of an ongoing investigation and considers all stakeholders (e.g., potential victims, consumers, investors, employees, regulators).

4. Insurance coverage: Employers should consult regularly with internal Audit, Legal and Risk Management teams, and holistically review their risk for sexual harassment and employment-related claims based on historical claims, policies, practices, the employee population, industry and any other relevant or company-specific data. After evaluating the potential exposure, organizations should consider whether an insurance policy would be appropriate as well as the proper level and scope of coverage. When evaluating the potential exposure, organizations should be aware of the remedies typically sought and awarded in harassment suits, which include economic and compensatory damages, punitive damages, and equitable relief, in light of the coverage available under insurance policies.

5. Claims handling: Insurance carriers should be trusted business partners, not only at the point of sale, but also when handling claims. In this regard, organizations should review insurance policies (with the help of internal/external counsel) and be aware of required notices regarding reportable events, such as a complaint filed in court or with a governmental agency. Employers should also familiarize themselves with a policy's deductible limit(s) and the scope of coverage and proactively establish relationships with claims management personnel. Additionally, organizations should avail themselves of the various pre-claim resources offered by their insurance carriers, such as employment hotlines offering pre-claim advice.

Tobias Spruill-Lewis
Senior Counsel, Employment Law Group, QBE North America

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Moire Moron
Assistant Vice President, Claims Practice Leader, QBE North America

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As one of the top 20 carriers worldwide, QBE is an integrated specialist insurer with 14,000 employees around the globe. In an increasingly volatile environment, the depth of our expertise with managing risk gives businesses the confidence and reassurance they need to invest, grow and prosper.

QBE's management liability products can help employers manage workplace-related risks. QBE's Solution for Employment Practices Liability responds to certain claims alleging a range of employment-related wrongful acts, including claims alleging harassment and other workplace torts. Such coverage can apply to employees' allegations that harassment resulted in emotional distress. QBE's Solution for Directors & Officers and Entity Liability and its Solution for Public Company D&O have a different scope, responding to certain claims brought against entities and their directors and officers alleging wrongdoing in connection with the management of the entity's business. Actual coverage is subject to the language of the policies as issued.

For additional information on how QBE assists organizations with reducing exposure regarding employment practice liability claims, please contact Tobias Spruill-Lewis at Tobias.Spruill-Lewis@us.qbe.com or Moire Moron at moire.moron@us.qbe.com.