

Taxation of Settlement Proceeds

A SUCCESS GUIDE

IRS CIRCULAR 230 DISCLOSURE

To ensure compliance with requirements imposed on us by IRS Circular 230 (31 C.F.R. part 10), we inform you that any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matter(s) addressed herein. Always seek the advice of a qualified tax professional before making any tax decisions.

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“Proceeds received from the settlement of a lawsuit are taxed depending on the conditions of the settled claim. Based on the nature of the case, settlement funds may be designated for a single purpose (such as personal injury), or a combination of reasons (such as personal injury, lost income, and attorney fees). It is important to understand that the tax treatment of settlement funds depends on the intended purpose of the funds.”

Personal Physical Injury or Sickness

Non-Taxable	Taxable
<p>If you received a settlement (structured or lump-sum) for a personal physical injury or sickness case and did not deduct any medical expenses incurred in prior years, the proceeds are non-taxable.</p>	<p>If you claimed a tax deduction in the prior year due to medical expenses resulting from the injury or sickness, the amount of the previous deduction is considered taxable income.</p> <p>If you claimed a tax deduction in multiple prior years due to medical expenses resulting from the injury or sickness, you must proportionally allocate the proceeds to medical expenses paid in previous years and claim the amount as taxable income. Refer to “Recoveries” in IRS Publication 525.</p> <p>Where would I report this income? <i>IRS Form 1040 line item “Other Income.”</i></p>

Emotional Distress or Mental Anguish

Non-Taxable	Taxable
<p>If the settlement is a result of emotional distress caused by personal injury or sickness, the proceeds are non-taxable.</p>	<p>If the settlement is a result of emotional distress that was not caused by personal injury or sickness, the proceeds are considered taxable income.</p> <p>You may deduct any medical expenses not previously deducted as a result of the emotional injury from the settlement proceeds income. You may also deduct any prior year medical expense deductions that did not provide a tax benefit from the settlement proceeds income. Refer to “Recoveries” in IRS Publication 525.</p> <p>Where would I report this income? <i>IRS Form 1040 line item “Other Income.”</i></p>

Real Estate or Personal Property

Non-Taxable	Taxable
<p>If the settlement proceeds are for damaged property and the settlement amount does not exceed the property's adjusted basis, the proceeds are non-taxable.</p>	<p>If the settlement proceeds are for damaged property and the amount exceeds the property's adjusted basis, the proceeds exceeding the adjusted basis are considered taxable income.</p> <p>Where would I report this income? <i>IRS Schedule D.</i></p>

Lost Wages

Taxable
<p>All settlement proceeds as a result of lost wages, salary, or employment benefits are considered taxable income.</p> <p>Where would I report this income? <i>IRS Form 1040 line item for form 1040 "Wages, salaries, tips, etc."</i> ~ OR ~ <i>IRS Form 1040 line item "Business income or (loss)." and Schedule SE for self-employment.</i></p>

Punitive Damages

Taxable
<p>All settlement proceeds for punitive damages, including punitive damages for personal injury or sickness, are considered taxable income.</p> <p>Where would I report this income? <i>IRS Form 1040 line item "Other Income."</i></p>

Interest Income

Taxable

All interest income received as a result of settlement proceeds is considered taxable income.

Where would I report this income?
IRS Form 1040 line item "Taxable interest."

Contingent Fees

Non-Taxable	Taxable
<p>Contingent fees paid for by a business:</p> <p>The contingent fees paid to an attorney by a company are considered a business expense and may be deducted from the business income.</p> <p>Contingent fees paid for an employment case:</p> <p>The contingent fees paid for a lawsuit regarding employment, such as lost wages, are considered deductible from gross income.</p>	<p>Contingent fees paid for by an individual:</p> <p>The contingent fees paid to an attorney are considered taxable income. However, the contingent fee may be deducted as an itemized deduction. If the person qualifies for the alternative minimum tax, the contingent fees may not be deducted.</p>

EPTC DISCLOSURE

The information here is intended to be educational and not tax advice and reflects the tax code as of May 2017.