

Settlements — Taxability

The Internal Revenue Service recognizes that receiving a settlement award (amount) from a personal injury suit may create new tax issues for some individuals. The following information is provided to assist recipients of cash settlements.

The type of settlement you receive is determined by your Final Settlement Agreement.

Physical injuries or physical sickness settlements are generally non-taxable.

- If you receive a settlement for physical injuries or physical sickness and did not take an itemized deduction for medical expenses related to this injury in prior years, the full amount is non-taxable and generally does not need to be reported on your income tax return.

BUT

- If you receive a settlement for physical injuries or physical sickness and did deduct medical expenses related to the injury, the tax benefit amount is taxable and should be reported as “Other Income” on line 21 of Form 1040.

Interest, punitive damages, emotional distress or mental anguish, and employment discrimination or injury to reputation settlements are generally taxable.

- **Interest:** Amounts on any settlement are generally taxable as “Interest Income” and should be reported on line 8a of Form 1040.
- **Punitive Damages:** Amounts are taxable and should be reported as “Other Income” on line 21 of Form 1040. It does not matter if punitive damages are related to a physical injury or physical sickness.
- **Emotional distress or mental anguish:** Amounts are taxable to the extent that they exceed medical costs, not previously deducted, for treatment of emotional distress or mental anguish. A statement showing the entire settlement amount less related medical costs should be attached to the return. The net taxable amount should be reported as “Other Income” on line 21 of Form 1040. Damages you receive for emotional distress or mental anguish directly due to a physical injury or sickness are treated as received for the physical injury or sickness. Because these payments qualify as medical, do not include them in your income.
- **Lost wages, lost profits, unlawful discrimination, or injury to reputation:** Amounts are taxable and should be reported as “Other Income” on line 21 of Form 1040.

Loss-of-use or loss-in-value of property settlements may be taxable if the settlement exceeds your basis in the property.

- Property settlements that are less than the adjusted basis of your property are not taxable and generally do not need to be reported on your tax return.
- When property settlements exceed your adjusted basis in the property, the excess is gain. Gains on personal capital assets are reported on Form 1040’s Schedule D, Capital Gains and Losses. Gains on business capital assets are reported on Form 4797, Sale of Business Property.

Some settlement recipients may need to make estimated tax payments if they expect their tax to be \$1,000 or more after subtracting credits & withholding. Information on estimated taxes can be found in IRS Publication 505, Tax Withholding and Estimated Tax, and in Form 1040-ES, Estimated Tax for Individuals.

For additional information, see Publication 525, Taxable and Nontaxable Income, visit our website at www.irs.gov, or call toll-free at 1-800-829-1040.

All of the forms and publications referenced in this publication are available from the IRS at www.irs.gov or paper copies can be ordered by calling 1-800-829-3676 (1-800-TAX-FORM).

