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Your legal settlement: what portion is excludible from tax?

According to the Insurance Information Institute, in 2017, 6% of homeowners filed property damage claims during 2013 to 2017. Of the claims, 2.05% per 100 house policies were due to water damage or to freezing temperatures.

According to numbers by the National Highway Traffic Safety Administration, approximately six million car collisions occur annually in the U.S. That's one in every ten seconds! 29.9% of accidents involve injuries.

In light of these odds, you have a fair chance of having to deal with litigation with your home or your vehicle, and it is wise to understand the tax consequences if you receive proceeds from a claim.

The IRS has guidelines for legal settlements to determine whether the income is includible or excludible in your tax return. The settlement documents should specify the type of damages received. Common types of damages awarded include property damage, compensatory damages, physical injury, pain and suffering, emotional distress and punitive damages.

According IRS guidance, punitive damages are included as taxable income.

Physical injury is excludible from income.

Property damages that are equivalent to replacement cost are excludible from income.

Pain and suffering and emotional distress may or may not be excludible from taxable income. If these damages are "on account of" (attributable to) physical injury they are excludible from taxable income. There are a number of cases in which the Tax Court held in favor of characterizing the income as excludible from tax.

Depending on the facts and circumstances, compensatory damages (lost wages) are excludible. If compensatory damages are on account of physical injury or sickness, they are excludible; if the lost wages are on account of property damage, they are excludible. It is imperative that the settlement clearly state the type of damages and amount of each agreed to.

It is important to know the specific facts and circumstances of these damages and how legal precedent and IRS rulings have been documented to determine the taxability of the damages received.



We welcome your comments and offer a complimentary meeting to discuss your specific situation with these tax law matters.

Regular Piece

How To Make The Most Of Your Newsletter

Be sure to read the article with the mindset 'How could this apply to our business.' Thinking of it that way will guarantee that you get value. Better yet, take notes as you read and commit to having the ideas implemented by the time the next edition arrives. Also, make copies for each team member. To really make sure something positive happens, work with your business development specialist to talk your team through the ideas and how to set a schedule for getting them implemented. We're here to help you get started.

An Important Message

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