

# Taxability of legal settlements

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Generally, if you receive amounts from settlements or insurance proceeds as a result of engaging in a specific business activity, it is subject to business and occupation (B&O) tax and, in some cases, retail sales tax. Examples include:

- Insurance proceeds.
- Court-ordered payments.
- Certain settlement agreements for lost business income.

## **Payments for engaging in a specific business activity**

If you receive payments after engaging in a specific business activity, the tax due is based on that activity. Some examples include:

- Breach of a retail construction contract where the other party did not pay the prime contractor for their construction services rendered (retailing B&O tax and retail sales tax).
- Breach of an engineering contract where the other party did not pay the engineering firm for their design services rendered (service and other activities B&O tax).
- Unauthorized use of intangible property (royalties B&O tax).

## **Absence of a specific business activity**

If you receive payments in the absence of a specific business activity, you owe B&O tax under the service and other activities classification. Some examples include payments you received from insurance for lost business:

- Not selling ski lift tickets due to a lack of snow.
- Lost business at a restaurant due to nearby road construction.
- Inability to license a defective patent.
- Inability to sell lost or damaged inventory.

## **Non-taxable proceeds**

If you receive payments for non-business purposes, such as personal injury or property damage (excluding inventory), you do not owe B&O tax on this income. This may also include certain insurance or other legal settlements.

Examples include payments you receive:

- To cover damage to operating assets.
- For personal injury.
- For eminent domain.

### **Example 1**

**Company A receives a settlement from a lawsuit over the unauthorized use of a copyrighted photograph in a magazine. Does Company A owe B&O tax on the settlement funds they received?**

Yes, Company A would owe B&O tax on the settlement funds. Company A would owe tax because they received a payment for the use of an intangible (albeit unauthorized). Here, Company A is in the business of selling photographs or granting licenses to use photographs. Because that is the case, they owe B&O tax on the amounts they received from the settlement under the royalties classification.

### **Example 2**

**Company B, an engineering firm, receives a settlement from an insurance claim for damages to its building caused by a vehicle that lost its brakes. Does Company B owe B&O tax on the settlement funds they received?**

If the settlement is for lost business, they owe B&O tax under the service and other activities classification.

If the settlement is for non-inventory property damage, they do not owe B&O tax.

### **Example 3**

**Company C, a moving company, receives payment from its landlord due to the landlord's breach of its real property lease with Company C. The landlord will no longer rent to Company C. Does Company C owe B&O tax on settlement funds they received for this breach?**

No. Company C received the settlement amount because their landlord's breached its lease. This is not business income for Company C.

## References

RCW 82.04.080 – Gross income of the business.

RCW 82.04.220 – Business and occupation tax imposed.



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