



Tax Impact of Job Loss



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Facts

JOB LOSS CREATES TAX ISSUES

The Internal Revenue Service recognizes that the loss of a job may create new tax issues. The IRS provides the following information to assist displaced workers.

- Severance pay and unemployment compensation are taxable. Payments for any accumulated vacation or sick time are also taxable. You should ensure that enough taxes are withheld from these payments or make estimated payments. See IRS Publication 17, *Your Federal Income Tax*, for more information.
- Generally, withdrawals from your pension plan are taxable unless they are transferred to a qualified plan (such as an IRA). If you are under age 59 ½, an additional tax may apply to the taxable portion of your pension. See IRS Publication 575, *Pension and Annuity Income*, for more information.
- Certain expenses incurred while looking for a new job may be deductible. Examples of deductible expenses include employment and outplacement agency fees, resume preparation, and travel expenses for job search and interviews. See IRS Publication 17, *Your Federal Income Tax*, for more information.
- Moving costs you incur because of a change in your job location may be deductible. You must meet certain criteria relating to distance moved and timing of the move. See IRS Publication 521, *Moving Expenses*, for more information.
- Some displaced workers may decide to start their own business. The IRS provides information and classes for new business owners. Please visit www.irs.gov or see IRS Publication 334, *Tax Guide for Small Businesses*, for more information.

Copies of all publications are available at www.irs.gov. You may also request a copy by calling 1-800-829-3676.



Q&A

JOB LOSS: What Income is Taxable?

The following Questions and Answers are provided by the Internal Revenue Service to clarify the tax implications of financial issues faced by workers who have lost their jobs. References are provided for additional information.

Is Severance Pay taxable?

Yes, severance pay is taxable in the year that you receive it. Your employer will include this amount on your Form W-2 and will withhold appropriate federal and state taxes. See Publication 525 for additional information.

What about Accumulated Leave or Vacation Pay and Sick Pay?

Yes, annual, or vacation pay, and sick pay are calculated as wages by your employer and will be included in your Form W-2.

Is Unemployment Compensation taxable?

Yes, your state unemployment insurance benefits (up to 26 weeks) and your extended benefits (up to an additional 13 weeks) are taxable. You may choose to have 10% withheld for federal taxes by completing Form W-4V. The State will provide you with a Form 1099-G prior to January 31st of each year, showing the amount of taxable benefits paid in the prior year. See Publication 525 for additional information.

What about Gifts of Cash and Property from Family or Friends?

Generally, the person who receives the gift is not liable for any taxes on the gift. If the gift produces income like interest, dividends or rent payments, the receiver would be responsible for taxes on the income. Gifts up to \$11,000 do not create a taxable event to either the giver or the receiver. Gifts in excess of \$11,000 may be subject to a gift tax. See Publications 17 or 950 for additional information.

If I am eligible for Public Assistance or Food Stamps, is it taxable? No.

When will I get my final Form W-2 from my employer?

Your employer must provide your Form W-2 by January 31st after the close of the calendar year. As an example, 2002 Forms W-2 are due to employees by January 31, 2003.

What if my employer filed bankruptcy or went out of business, how do I get my Form W-2?

In either case the employer must file and report your wages and withholding on a Form W-2 at year's end. If you do not receive your Form W-2, try to contact your employer or their representative. If you are unsuccessful, the IRS can assist you in filing a substitute Form W-2 using your records. A good precaution is to keep year-to-date records or pay stubs until you receive your Form W-2.

Can I file an early tax return and receive any refund due?

No. Individual income tax returns are based on a calendar year and cannot be filed and processed earlier than January 1st of the next calendar year.

If I sell other assets like stocks, bonds, and investment property, are they immediately taxable?

Not necessarily, however the sale of such assets should be reported. If you have a gain on the sale, it may generate an income tax liability. You should review your overall tax situation and make sure you have paid your taxes as required to avoid any estimated tax penalty. Information on estimated tax is in Publication 505.

What can I do if I owe taxes and cannot pay them?

Contact the Internal Revenue Service as soon as possible to develop a plan. Communication is the key to minimizing problems.

Is special assistance available on unresolved tax matters that create hardships?

Yes, if you are suffering, or are about to suffer a significant hardship because of the way tax laws are being carried out (tax liens, levies, property seizures, etc.) you may seek help from the IRS Taxpayer Advocate Program by calling toll-free **1-877-777-4778**.

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Q&A

JOB LOSS: Pensions/IRA's - What's Next?

The following Questions and Answers are provided by the Internal Revenue Service to help you handle financial issues with a tax impact which may arise if you lose your job.

What if I withdraw money from my qualified retirement plan or IRA?

Generally speaking, if you withdraw the funds before you reach eligible age, and do not roll it over into another qualified retirement plan or Individual Retirement Account (IRA) within 60 days, that amount will be taxable income in the year in which it is withdrawn. You may also have to pay an additional 10% tax on those early distributions. There are special rules for computing tax on lump-sum distributions. See IRS Publication 17 or Publication 575 for detailed information.

Can I move money from my qualified retirement plan into another qualified retirement plan or IRA?

Yes, this is called a "rollover" and the amount will not be taxed if you redeposit the amount withdrawn into another qualified retirement plan or traditional IRA within 60 days. See Publication 575 for additional information.

Are there any "hardship" exceptions to the early distribution penalties?

Yes. If you are totally and permanently disabled or if you withdraw the money to pay medical expenses (these expenses must be more than 7.5% of your adjusted gross income) or to pay an alternate payee under a qualified domestic relations order. Other specific exceptions are detailed in Publication 575.

If I made an IRA contribution during the current tax year, can I withdraw it before the close of the year?

Yes. Contributions returned before the due date of the return can be withdrawn without penalty. You must take not only the contribution but any interest or dividend it may have earned. This is a tax-free event if (1) you do not take a deduction for the contribution and (2) you withdraw any income or interest the investment made while in the IRA and include that amount in your income. See Publication 590, Individual Retirement Arrangements for more information.

I've had my IRA's for several years, in some of those years I didn't benefit from any deduction due to my income. How do I figure what part of the distribution is taxable?

If you had non-deductible IRA contributions, you would have completed Form 8606 to establish your basis (cost) in your combined IRA's. Use the worksheet in Publication 590 to calculate what part of the distribution is taxable and complete section 2 on Form 8606 and attach it to your return..

If I take my pension and want to transfer it to an IRA, are there any special rules or restrictions?

Rolling over your pension distribution to a financial institution: (i.e., bank, credit union, brokerage house, etc.) is straightforward. There are some prohibited transactions including borrowing the distribution even with a signed contract with interest due, receiving unreasonable compensation for managing these funds, buying property for personal use (present or future), or using the distribution as security for a loan. Review the information in Publications 575 and 590 for additional information.

In addition to the Publications 17, 575 and 590, take advantage of every resource including your financial and/or tax advisor before deciding how to proceed in transitioning your retirement funds. Copies of the referenced publications can be found at www.irs.gov or you may call 1-800-829-3676.

Q&A

JOB LOSS: Starting Your Own Business

Every new phase of life brings many challenges. The Internal Revenue Service recognizes that the loss of a job can create new tax situations for you. The following information is provided to clarify possible tax implications.

Can I be an Employee and a Business Owner in the same tax year?

Yes. Under the tax law, you can be both an Employee and a Business Owner at the same time if you choose. The primary issue is to report all income on your return.

Where can I get information about starting my own business?

Publication 334, Tax Guide for Small Business and Publication 3207, The Small Business Resource Guide CD ROM 2002 provides tax related information. These publications contain information on starting your own business, record keeping, and deductible expenses. In addition, Publication 3207 contains all of the business tax forms, instructions and publications needed by small business owners.

What options do I have for organizing my business?

Under the federal tax code, there are three options: Sole Proprietorship, Partnership or Corporation. A number of factors may influence your decision about which structure is best for you including cost of start-up, exposure to risk or liability, financing and the tax implications.

What record keeping requirements do I have as a Sole Proprietor?

Generally, you should keep detailed records of your income and expenses for your business to prepare not only required tax returns but also financial statements to help in maintaining and growing your business. The same general rules apply for Partnerships and Corporations with some additional detail.

How do I report my business income?

As a Sole Proprietor, you will need to file a Form 1040, Schedule C or C-EZ and Schedule SE. For more information, please see Publication 334, Tax Guide for Small Business.

What kinds of taxes do I pay as a Sole Proprietor?

Taxes due on net self-employment income (total business income minus expenses) include income tax and self-employment (Social Security) taxes. Additional information is available in Publication 533, Self-Employment Tax. You may be responsible for Employment Taxes if you have employees working in your business, see Publication 15, Circular E, Employer's Tax Guide for details.

How do I pay my taxes as a Sole Proprietor?

Generally, you would pay using the 1040ES Estimated Tax process on a quarterly basis. Federal income taxes including Self-Employment tax use a pay-as-you-go system. You generally must make estimated tax payments if you expect to owe taxes of \$1,000 or more when you file your return. For more information on Estimated Tax see Publication 505. Employment taxes are paid using Forms 941, Employer's Quarterly Federal Tax Return, and Form 940, Employer's Annual Federal Unemployment Tax Return. The filing requirements for each of these forms and instructions about how to pay taxes due are included in the Publication 15, Circular E, Employer's Tax Guide.

Can I claim the Earned Income Credit on my net self-employment?

Net income from a Sole Proprietorship is earned income. The Earned Income Credit is available to taxpayers that meet certain income guidelines. See Publication 596, Earned Income Credit.

Are classes or seminars available to get additional information?

Yes. The Small Business/Self-Employed Division of the Internal Revenue Service has a number of Small Business seminars through out the nation. You can also order Publication 3700, A Virtual Small Business Workshop CD ROM or you can view it over the web at www.irs.gov/smallbiz. Other products are available to order at the Small Business Web Site as well.

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Q&A

JOB LOSS: Miscellaneous Tax Information

Every new phase of life brings many challenges. The Internal Revenue Service recognizes that the loss of a job can create new tax situations for you. The following information is provided to clarify the tax implications.

Can I deduct any of the expenses that I have from looking for a new job?

Yes, you can deduct certain expenses for looking for a new job in your present occupation, even if you do not get a new job. For additional information, see Publication 529, Miscellaneous Deductions.

What types of expenses can I include?

Generally, you can deduct employment and outplacement agency fees for work in your occupation. You can also deduct amounts for typing, printing and mailing copies of your resume to prospective employers. More specific information is available in Publication 529, Miscellaneous Deductions.

What about travel costs for interviews or job hunting?

If you travel to an area to look for work in your occupation or attend an interview you can generally deduct the ordinary and necessary travel costs. The purpose of the trip must be considered. Trips that are primarily personal are not deductible. For more information on how to compute your travel expenses, see Publication 463, Travel, Entertainment, Gifts and Car Expense.

Do I need to file the “long-form” to deduct my job hunting costs?

Yes, you will need to file a Form 1040 and Schedule A. Job hunting costs are a miscellaneous itemized deduction, subject to a 2% Adjusted Gross Income limitation. For more information, please see Publication 17, Your Federal Income Tax.

Can I deduct the moving costs I paid to move to my new job?

Certain moving costs are deductible if you meet the time and distance requirements. Generally, your move has to be closely related in time to the start of your new job and you must have moved at least 50 miles. Deductible moving costs are calculated on Form 3903. Publication 521, Moving Expenses, provides additional information.

If I sell my home, do I have to pay taxes on the money I make?

Usually you do not have to pay tax on the first \$250,000 (\$500,000 on a joint return in most cases) of gain from the sale of your main home. Generally, you must have lived in and owned the home for at least two years. For more information, see Publication 523, Selling Your Home.

Now I have to pay the full cost for my health insurance. Is this deductible?

Health insurance premiums are includible in your medical and dental bills. They are deductible on Schedule A, if you itemize. Some limitations apply. See Publication 502, Medical and Dental Expenses, for more information.

Can I claim the Earned Income Credit this year?

Even though your income may have exceeded the thresholds for this credit in past years, you may be eligible for the credit this year. The credit is available to taxpayers who meet certain income guidelines. For more information, see Publication 596, Earned Income Credit.

My chances of finding a new job will be better if I take a few college courses. Can I deduct any of my tuition?

You may qualify for the Hope or Lifetime Learning educational credits. Sometimes, the tuition costs can even be an itemized deduction. For more information, see Publication 970, Tax Benefits for Higher Education.

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