Publication **4128**

Tax Impact of Job Loss

The Life Cycle Series

A series of informational publications designed to educate taxpayers about the tax impact of significant life events.

Publication 4128 (Rev. 5-2020) Catalog Number 35359Q Department of the Treasury **Internal Revenue Service** www.irs.gov

Facts

References

- **Publication 17, Your Federal Income Tax (For Individuals)**
- **Publication 575, Pension and Annuity Income**
- **Publication 334, Tax Guide for Small Businesses**

JOB LOSS CREATES TAX ISSUES

The Internal Revenue Service (IRS) 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 1⁄2, an additional tax may apply to the taxable portion of your pension. See IRS Publication 575, Pension and Annuity Income, for more information.
- Job hunting and moving expenses are no longer deductible.
- Some displaced workers may decide to start their own business. The IRS provides information and classes for new business owners. See IRS Publication 334, Tax Guide for Small Businesses, for more information. If you are unable to attend **small business tax workshops, meetings or seminars** near you, consider taking **Small Business Taxes: The Virtual Workshop** online as an alternative option.

Important Note about Health Insurance Coverage. If you, your spouse, or your dependent enrolled in health insurance coverage through the Health Insurance Marketplace and you have a change in circumstances such as a change in income, let the Marketplace know about it. Certain changes in circumstances - like loss of a job or employer provided health insurance coverage - may also open the door for a Marketplace special enrollment period allowing you to make changes in your health care plan when it's not open season. Reporting changes will help you get the proper type and amount of financial assistance so you can avoid getting too much or too little assistance in advance. Find out more about the tax-related provisions of the health care law at **www.irs.gov/aca**.

Q&A

References

- **Publication 17, Your Federal Income Tax (For Individuals)**
- **Publication 505, Withholding and Estimated Tax**
- **Publication 525, Taxable and Nontaxable Income**
- **Form W-2, Wage and Tax Statement**
- **Form W-4V, Voluntary Withholding Request**
- **Form 1099-G, Certain Government Payments**
- **Instructions** and **Form 709, United States Gift Tax Return**

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, Taxable and Nontaxable Income, for additional information.

Is accumulated leave (vacation and/or sick pay) taxable?
Yes, annual leave/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 are taxable. You may choose to have 10% withheld for federal taxes by completing Form W-4V. The State will provide you with a paper Form 1099-G or make it available electronically by 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 that produced income. Each year there is a specific maximum amount that may be given that will not create a taxable event to either the giver or the receiver. Gifts in excess of this maximum may be subject to gift taxes by the gift giver. See Publication 17, Your Federal Income Tax (For Individuals) or Instructions to Form 709, United States Gift Tax Return, 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, 2020 Forms W-2 are due to employees by January 31, 2021.

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.

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JOB LOSS: **What Income is Taxable?** (continued)

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 earlier than January of the next calendar year. By law, Internal Revenue Service cannot issue refunds claiming the Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC) before mid-February. This applies to the entire refund – even the portion not associated with the EITC or ACTC.

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, Withholding and Estimated Tax.

What can I do if I owe taxes and cannot pay them?
Contact the Internal Revenue Service as soon as possible to request a payment plan. Communication is the key to minimizing problems.

Payment options include a short-term payment plan (paying in 120 days or less) or a long-term payment plan (installment agreement for payments longer than 120 days). You may qualify to apply online for one of these **payment options**.

Is special assistance available on unresolved tax matters that create hardships?
Yes, if you are experiencing economic harm, a systemic problem or are seeking help in resolving tax problems that have not been resolved through normal channels, you may be eligible for **Taxpayer Advocate Services (TAS)** assistance.

Q&A

References

- **Publication 17, Your Federal Income Tax (For Individuals)**
- **Publication 575, Pension and Annuity Income**
- **Publication 590-A, Contributions to Individual Retirement Arrangements (IRAs)**
- **Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs)**
- **Form 8606, Nondeductible IRAs**

JOB LOSS: **Pensions/IRAs – 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 Individual Retirement Arrangement (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, Your Federal Income Tax (For Individuals) or Publication 575, Pension and Annuity Income for detailed information.

Are there any "hardship" exceptions to the early distribution penalties?
Yes, there two exceptions specifically related to job loss. The additional 10% tax does not apply for distributions from a qualified retirement plan if you are age 55 (age 50 for qualified public safety employees) in or after the year of separation from service. Also, you do not have to pay the additional tax on distributions during the year from an IRA that aren't more than the amount you paid during the year for medical insurance for yourself, your spouse, and your dependents. To qualify, you must have:

1. lost your job,
2. received unemployment compensation paid under any federal or state law for 12 consecutive weeks because you lost your job,
3. received the distributions during either the year you received the unemployment compensation or the following year **and**
4. received the distributions no later than 60 days after you have been reemployed.

For other exceptions not related to job loss but may apply, see Publication 575 and Publication 590-B, Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs).

Can I move money from my qualified retirement plan into another qualified retirement plan or IRA?
Yes, this is called a "rollover". You can choose to have any part or all of an eligible rollover distribution paid directly to another qualified retirement plan that accepts rollover distributions or to a traditional or Roth IRA.

If you choose the direct rollover option, or have an automatic rollover, no tax will be withheld from any part of the distribution that is directly paid to the trustee of the other plan. If any part of the eligible rollover distribution is paid to you, the payer must generally withhold 20% of it for income tax.

However, the full amount is treated as distributed to you even though you actually receive only 80%. You generally must include in income any part (including the part withheld) that you don't roll over within 60 days to another qualified retirement plan or to a traditional or Roth IRA. See Publication 575, Pension and Annuity Income for additional information.

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JOB LOSS: **Pensions/IRAs – What's Next?** (continued)

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 the contribution and 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-A, Contributions to Individual Retirement Arrangements (IRAs) for more information.

I've had my IRAs 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, Nondeductible IRAs, to establish your basis (cost) in your combined IRAs. Use the worksheets in Publication 590-A and Publication 590-B to calculate what part of the distribution is taxable and complete Part I on Form 8606 and attach it to your return.

If I take my pension and 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. Prohibited transactions with an IRA include:

1. borrowing money against it,
2. selling property to it,
3. using it as security for a loan or pledging the IRA account as security **or**
4. buying property for personal use (present or future) with IRA funds. In general, there is a 15% tax on the amount of the prohibited transaction and a 100% additional tax if the transaction isn't corrected. Review the information in Publications 575, 590-A and 590-B for additional information.

Who can I talk with to discuss distributions from my retirement accounts and the affect it will have on my tax liability?
If you are unable to find the answers to your questions or have additional questions after researching Publications 17, 575, 590-A and 590-B, contact your plan administrator, financial planner or tax advisor.

Q&A

References

- **Publication 15, (Circular E), Employer's Tax Guide**
- **Publication 334, Tax Guide for Small Businesses**
- **Publication 505, Withholding and Estimated Tax**
- **Publication 583, Starting a Business and Keeping Records**
- **Publication 596, Earned Income Credit**
- **Publication 4591, Small Business Federal Tax Responsibilities**
- **Form 940, Employer's Annual Federal Unemployment Tax Return**
- **Form 941, Employer's Quarterly Federal Tax Return**
- **Form 1040, U.S. Individual Income Tax Return**
- **Schedule C, Profit or Loss From Business (Sole Proprietorship)**
- **Schedule SE, Self-Employment Tax**

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, Publication 583, Starting a Business and Keeping Records are free publications that have helpful information for small business owners. In addition, Publication 4591, Small Business Federal Tax Responsibilities, provides a summary of the reference material for the business owner. These products contain information on starting your own business, record keeping, and deductible expenses.

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, Profit or Loss From Business (Sole Proprietorship) to report your income and eligible business expenses. You may also be eligible to deduct up to 20 percent of qualified business income (QBI) from domestic businesses operated as sole proprietorship regardless of whether you itemize your deductions on Schedule A or take the standard deduction. Limitations for the QBI deduction may apply. For more information, please see Publication 334, Tax Guide for Small Business, and Publication 535, Business Expenses.

What kinds of taxes do I pay as a sole proprietor?
Taxes due on your net self-employment income (total business income minus expenses) include federal income tax and self-employment (Social Security and Medicare) taxes and they are reported on Schedule SE, Self-Employment Tax. Additional information is available in Publication 334, Tax Guide for Small Businesses. You are responsible for employment taxes if you have employees working in your business. See Publication 15, (Circular E), Employer's Tax Guide, for details.

JOB LOSS: **Starting Your Own Business** (continued)

How do I pay my taxes as a Sole Proprietor?
Federal income taxes including Self-Employment tax use a pay-as-you-go system. Generally, you would pay using the 1040ES Estimated Tax process on a quarterly basis. 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, 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 on how to pay these taxes and due dates are included in the Publication 15, Circular E, Employer's Tax Guide.

Can I claim the Earned Income Credit on my net self-employment income?
Yes, net income from a Sole Proprietorship is earned income and is one of the qualifications for earned income credit. 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 (SB/SE) Division of the Internal Revenue Service has a number of Small Business seminars through out the nation. If you are unable to attend **small business tax workshops, meetings or seminars** near your, consider taking **Small Business Taxes: The Virtual Workshop** online as an alternative option. Other online learning tools are also available on the **SB/SE Tax Center**.

Q&A

References

- **Publication 502, Medical and Dental Expenses**
- **Publication 523, Selling Your Home**
- **Publication 596, Earned Income Credit**
- **Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans**
- **Publication 970, Tax Benefits for Education**
- **Form 1040, U.S. Income Tax Return**
- **Schedule A, Itemized Deductions**

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.

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 of the five years prior to the sale and not excluded a gain on another home in the past 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 deduct contributions I made to a Health Savings Account (HSA)?
If you are an eligible individual, you can claim a tax deduction for contributions you, or someone other than your employer, make to your HSA even if you do not itemize your deductions on Form 1040. For more information see Pub 969, Health Savings Accounts and Other Tax-Favored Health Plans.

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?
There are a number of tax benefits available for going to college or taking college courses. Some of the benefits are credits and others are deductions from your income. Refer to Publication 970, Tax Benefits for Education, for more information.