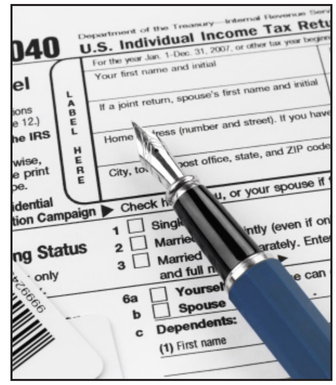

SALARY

Taxes and Unemployment Checklist

Laid off? Watch for these stumbling blocks when planning fiscal 2009.

By John Hazard

YOU'VE BEEN LAID OFF, and you're watching your pennies. You need to focus on your job search now — but to keep on the right side of the IRS, here's a simple panel of financial levers you'll need to pull along the way.

A couple of notes before we start: These pieces of your financial puzzle apply specifically to federal taxes; your mileage may vary state to state and town to town. Indeed, this list can't substitute for financial advice from your own accountant; please consult a pro with specific questions. Unless otherwise noted, the material here was drawn from IRS Publication 17. And in case you're wondering, your memberships to TheLadders and other job boards are tax deductible. ■

1. Severance, Vacation and Sick Pay

Why it matters:

Severance and any payments for accrued vacation and sick time are considered part of regular wages for the year in question. That means taxes, Social Security and Medicare should be withheld at the same rates they were while you were employed.

What to watch for:

- ☐ Vacation and sick time are generally paid out in one lump sum with taxes withheld. Make sure that's true for you.
- ☐ Some employers will offer a laid-off employee the option to receive their severance at once or in installments. Will scheduled payments stretch into another calendar year? That could change your income for the year and thus your tax liability.
- ☐ Have you maxed out your FICA contributions? If so, it might be best to take a lump sum instead.

2. Outplacement Services

Why it matters:

If you're lucky enough to receive outplacement services as part of your separation from your employer (such as training in interview techniques or help writing a resume), the IRS may consider that taxable income.
(IRS Publication 15-A)

What to watch for:

Outplacement services should be **tax-exempt** if:

- ☐ The services are based on need.
- ☐ Your former employer can claim a business benefit, such as improved employee morale or public relations. (Talk to your HR department to get the skinny.)
- ☐ You would be able to deduct the costs anyway. (Ask your accountant.)

2. Outplacement Services (continued)

Outplacement services are **taxable** if:

- [ ] Your employer offers outplacement services in lieu of a reduced severance. In that case, you must report the difference as income. The IRS instructs employers to withhold taxes as part of severance, but double-check with your former company to make sure they've connected those dots. (By the way, you can probably deduct the difference.)

3. Supplemental Unemployment Benefits

Why it matters:

If your former employer agrees to extend you benefits such as low-interest loans, or use of a vehicle or housing, the IRS will consider those items taxable income. *(IRS Publication 15-A)*

What to watch for:

- [ ] Your former employer is unlikely to withhold taxes for these benefits. Check with your employer and book time with a tax attorney to determine what items are tax-exempt and be prepared to cover the taxes on those that aren't.

4. 401(k), IRA and Qualified Retirement Plans

Why it matters:

If you've lost your job, you're likely to lose your enrollment in the company's 401(k) program. How you handle the funds that come your way can affect your tax exposure.

What to watch for:

- [ ] Distributions from IRAs and 401(k)s are tax-exempt, but the clock is ticking: You have 60 days to move all or part of it to another eligible retirement account without penalty. After that, the money may be taxed up to 20 percent.
- [ ] Younger than 60? Any taxable portion not rolled over may be subject to an additional 10 percent penalty on early distributions, and even steeper penalties may apply. Move it or lose it.
- [ ] Some 401(k)s allow you to withdraw a temporary loan or a hardship distribution to cover the bills. Be aware: An interest-bearing loan is tax exempt, but a withdrawal is subject to taxes and penalties. Make sure you know the difference before you touch your nest egg.

5. Unemployment Compensation

Why it matters:

Unemployment compensation is taxable income.

What to watch for:

- [ ] You have a choice here: You may decide to withhold 10 percent (the minimum U.S. tax) of your unemployment benefits for federal taxes (Form W-4V); you can pay estimated quarterly tax; or you can pay it all come April 15. Be aware: Whichever option you choose, you will be taxed based on your gross income for the year. Chances are you will owe more for the year than the 10 percent you paid.

Here's an example: Say you earned $5,000 in unemployment during the year and paid $500 at the 10 percent rate, but your total income for the year was $75,000 (in taxable wages). In that case, you are still

5. Unemployment Compensation (continued)

in the 25 percent tax bracket and would be obligated to pay an additional $750 in taxes on your unemployment.

- [ ] The first $2,400 of unemployment payments in 2009 are tax exempt under the American Recovery and Reinvestment Act.
- [ ] Some companies, unions and individuals arrange for private unemployment insurance, called "supplemental unemployment." Payments are considered wages and taxed at a standard rate. The original amount you paid into the fund is tax exempt.

6. Mortgage and Payment Assistance

Why it matters:

While between jobs, you may use payment-protection plans and programs that help cover your bills. Some of these are tax exempt.

What to watch for:

- [ ] Mortgage-assistance payments covered by the National Housing Act are tax exempt.
- [ ] Property-tax relief and payments made by a state or municipality to help pay utility bills are generally tax exempt.
- [ ] Payment-protection (creditor) insurance, including programs offered by automakers, may be tax exempt, but slow down and check with your provider and accountant – it may be considered income.

7. Selling Investments and Assets to Pay the Bills

Why it matters:

If you sell investments and property to help pay the bills, the proceeds will most likely be considered taxable income.

What to watch for:

- [ ] For investment properties, taxable income depends on the type of property, its value and how long you've owned it. It may be ordinary income subject to regular income tax rates, or it may be considered a capital gain, subject to a separate rate. *(IRS Publication 544)*
- [ ] If you sell your primary residence, profits may be tax exempt up to $250,000 ($500,000 if you are married and filing jointly). *(IRS Publication 523)*

8. Self-employment

Why it matters:

If you choose to work for hire during your layoff, there are a whole new set of rules that govern self-employment.

What to watch for:

- [ ] If you work as a contractor or open your own business, you will need to file a 1099 form and pay out for taxes, Social Security and Medicare.
- [ ] If you plan to work for yourself for an extended period of time and expect to pay more than $1,000 in taxes on earned income, the IRS recommends you make quarterly estimated tax payments. Like payroll withholding tax, you may still owe money at the end of the year, or you may receive a refund.

9. Deductions

Why it matters:

The rules change when your income changes. You can take advantage of deductions previously unavailable — but handle them with care.

What to watch for:

1. ☐ **Earned Income Tax Credit**

   You may not have qualified in prior years, but your reduced income may meet the standard. Talk to an accountant or check the IRS EITC assistant to find out.

2. ☐ **Health Care**

   If you're paying for your own medical bills or health insurance, your expenditures can probably be itemized deductions. An accountant can tell you if income qualifications apply.

   Premium payments for COBRA (continued health insurance) are generally not tax deductible, but under the American Recovery and Reinvestment Act, you may be able to put most of the burden on your employer, if you qualify.

3. ☐ **Job-Hunting Expenses and Itemized Deductions**

   If you're looking for a job in your current field, you may deduct certain expenses related to the search, including:

   a. ☐ Memberships to job boards like TheLadders

   b. ☐ Career services such as resume assistance and interview preparation

   c. ☐ Travel to interviews

   d. ☐ Phone calls related to the search

   e. ☐ The cost of copying and preparing your resume

   f. ☐ Child care (or care for other dependents) while you are job hunting *(IRS Publication 529)*

4. ☐ **Moving Expenses**

   If you move more than 50 miles for a new job, you may be able to deduct your moving expenses, but there are rules about the distance and timing of the move, and the job must be related to your current field. *(IRS Publication 521)*

5. ☐ **Education and Training**

   Tuition and fees for most classes and training programs are likely to be tax deductible. *(IRS Publication 970)*

6. ☐ **Home Office**

   If you decide to perform contract work or start your own business during a layoff, you may be able to deduct some of the costs of maintaining a home office. You must dedicate a portion of your home exclusively to business use.

If You Owe

If it turns out you're obligated for taxes you can't pay, the IRS recommends you nevertheless file a return on time and pay what you can. You will still be charged interest on the amount owed and assessed late-payment penalties, but you'll avoid the penalty for failing to file a tax return. You can also arrange at that time for a payment plan.