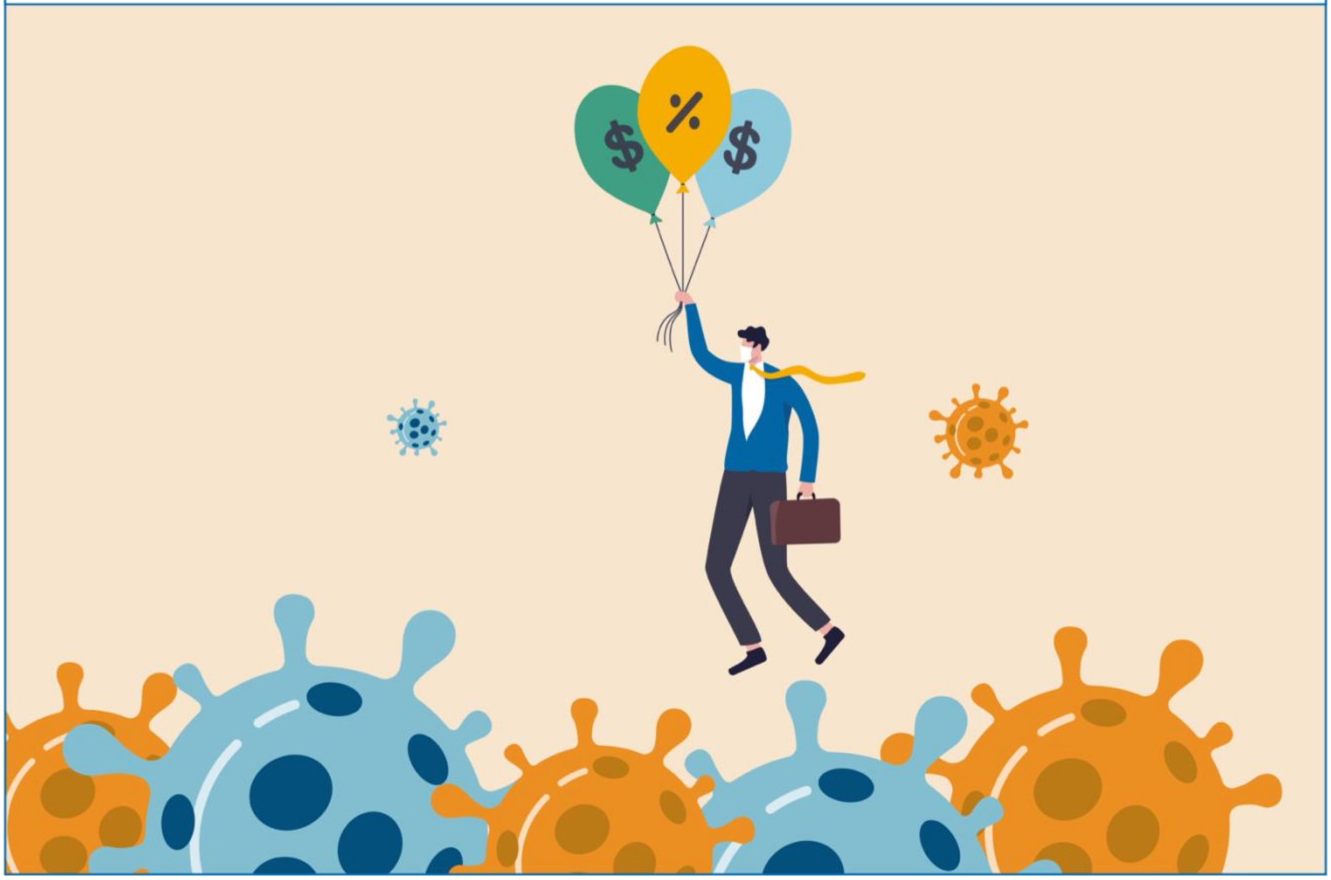
ISLAND FEDERAL BLOG



Navigating Coronavirus’s Impact on Tax Season

With hundreds of billions of dollars in stimulus money, business loans, and unemployment benefits floating around, everyone is trying to keep up with what all this means for you when you sit down to file your taxes this year.

First, don’t panic! Here are some answers to some of the biggest questions about how the coronavirus (and everything that followed because of it) might affect your 2020 tax returns, plus some action steps you can take to prepare yourself and avoid any nasty “Tax Day” surprises.

Will the stimulus check money I received be taxed?

Simple Answer…Nope. The stimulus money that you received from Uncle Sam *will not* count as taxable income. So that’s one less thing you have to worry about when Tax Day rolls around! Why isn’t that money being counted as taxable income? Because it’s being treated like a refundable tax credit for 2020. Translation: Your stimulus check is sort of like an advance on money you would have received anyway as part of your tax refund in 2021.

I took money out of my 401(k). What's going to happen with the money I took out?

Another thing the CARES Act did is allow people to take a type of "hardship withdrawal" of up to $100,000 out of their retirement accounts until the end of 2020 without having to pay the usual 10% early withdrawal penalty.

But even *without* the early withdrawal penalty, you'll still have to pay income taxes on any money you take out of your traditional 401(k)s and IRAs. If you're not careful, you could bump yourself into a higher tax bracket and owe Uncle Sam even more in taxes for this year. The CARES Act allows you to return any funds within the next three years and file an amended return.

I lost my job and received unemployment benefits. Are those benefits taxable?

Yes, any unemployment benefits you received in 2020 *will* count as taxable income.
Millions of Americans lost their jobs or were furloughed amid the lockdowns and economic shutdowns, leading to record numbers of people signing up for unemployment benefits. The CARES Act also allowed the freelancers, independent contractors, and the self-employed to file for Pandemic Unemployment Assistance, a program designed to help folks not usually eligible for unemployment benefits.

I took on some side jobs to make up for some lost income. What should I expect?

Like a lot of people, you might have had to take on a side gig or two to replace lost income to ride out the pandemic. It's important to know that the money you made freelancing or doing odd jobs here, and there *will* be taxed. A good tip is to set aside 25–30% of every paycheck from your side hustle for taxes. That way, you're not scrambling around to pay your taxes when the deadlines roll around.

I'm working remotely for my company from a different state. How will that impact my taxes?

This one's a little tricky. According to the Pew Research Center, 1 out of 5 Americans relocated because of the pandemic or know someone who did. If you're one of those remote workers who crossed state lines, you might be in for a tax surprise—and not the good kind.
You see, each state has its own tax system with its own set of rules—and most states that have their own income tax *will* impose them on anyone doing work in their state.

A few states already have "reciprocity agreements" in place that prevent income from being taxed twice, and a few others have offered tax relief for remote workers because of the pandemic. But some states are not budging on their state tax laws. That means a lot of folks who work in one state but live in another could end up owing taxes in *two* states this year. Check your state's tax laws and get in touch with a tax professional who will be able to help you figure out which state governments you might be getting a tax bill from.

Since I was working from home, I can claim the home office deduction on my tax return, right?

Generally, a home office tax deduction is only available for self-employed individuals, freelancers, or independent contractors who have a home office that is used *exclusively* for business purposes on a *regular basis.* That means office workers sent home by their employers during the pandemic don't count since they don't work exclusively out of their homes.

My company decided to defer my payroll taxes for the remainder of 2020. What does that mean?

Some workers might have noticed that their paychecks got slightly bigger during the last few months of 2020. That's because the Trump administration signed an executive order that allows companies to defer payroll taxes (Social Security payroll taxes, to be specific) from Sept. 1, 2020, to Dec. 31, 2020. So if you're a federal government employee or work at a company that decided to defer your Social Security payroll taxes for the rest of 2020, you saw a temporary 6.2% bump in your paychecks. Don't jump for joy just yet, because there's a catch.

The keyword here is *deferred.* This is not a tax break—those taxes still need to be paid. That means companies will have to make up that money between January and April 2021, so you'll be seeing *less* money in your paycheck during that time. So brace yourself for that!

I tested positive for COVID-19 and piled up a bunch of medical expenses as a result. Can I deduct those costs from my taxes?

Answer… It depends. The IRS lets you deduct medical, dental, and other health expenses that fall above 7.5% of your adjusted gross income (that's the part of your income that is taxable) for the year. But here's the kicker: You can *only* deduct medical expenses if you choose to pass on the standard deduction and itemize your deductions instead. Does it make sense to itemize your deductions? For 2020, the standard deduction is $12,400 for single filers and $24,800 for married couples. It really only makes sense to itemize if your itemized deductions (including medical expenses) are greater than the standard deduction, so choose wisely!

I'm a small business owner who took out a PPP loan. How will that impact my taxes?

The CARES Act didn't just set out to help individuals and families—it also tried to provide some financial assistance for struggling small business owners by offering them Paycheck Protection Program (PPP) loans. These loans were designed to be "forgiven" as long as they were used for certain business expenses—particularly payroll, rent or interest on mortgage payments, and utilities. And while income from debt forgiveness usually counts as taxable income, the CARES Act makes an exception for PPP loan forgiveness. That means as long as you used those PPP funds for eligible expenses, that money *will not* be taxed, as long as your loan forgiveness application is approved (more on that in a minute).

But there are a few problems (aren't there always?): The IRS says that any expenses you paid with money from those PPP loans *cannot* be deducted from your taxable income. So if you applied for a PPP loan, borrowed $100,000, and spent all of that money on payroll, rent, and utilities, you won't be able to deduct a dime of those business expenses from your taxes like you usually would.

Without a doubt, this tax season is going to be a hot mess for millions of Americans who have seen their lives turned upside down by this pandemic. If you're one of them, it might be a good idea to reach out to a tax advisor who is up-to-date on the latest news and changes for this tax season. For a special TurboTax discount for Island Members, click here.

(source: https://www.daveramsey.com/blog/coronavirus-and-taxes)