



Don't overlook these tax issues after a job loss

Even with a relatively low unemployment rate (averaging around 4.4% over the past year), layoffs and terminations continue to affect workers across many industries. If you've recently lost your job, you're likely focused on replacing income and evaluating your next steps. But some tax implications related to a job loss also may require attention. Here are a few important areas to consider.

Unemployment, severance and other income

Many people are surprised to find out that federal unemployment compensation is taxable. (Some states *do* exempt it from state tax.) Although severance pay is also taxable and subject to federal income tax withholding, some elements of a severance package may get special tax treatment. For example:

Incentive stock options (ISOs). If you sell stock acquired by way of an ISO from your former employer, part or all of your gain may be taxed at lower long-term capital gain rates rather than at ordinary income tax rates — depending on whether you meet the required holding-period rules.

"Golden parachute" payments. If you received (or will receive) such a payment, you may be subject to an excise tax equal to 20% of the portion of the payment that, under complex rules, is treated as an "excess parachute payment." This is on top of ordinary income tax.

Job placement assistance. The value of such assistance you receive from your former employer usually is tax-free. However, the assistance is taxable if you had a choice between receiving outplacement help or cash.

Finally, be aware that payments from your former employer for accumulated unused paid time off, such as vacation time or sick time, are taxable.

Health coverage

If your former employer pays for some of your medical coverage for a period of time after termination, you won't be taxed on the value of the benefit.

Under the COBRA rules, employers that offer group health coverage generally must provide continuation coverage to most terminated employees and their families. The cost of COBRA coverage can be high because you typically will have to pay the portion your employer had been paying in addition to what you'd been paying as an employee. So you may want to look for your own coverage through the Health Insurance Marketplace at healthcare.gov to see if you can purchase less expensive coverage there.

Medical insurance premiums not paid pretax from a paycheck are potentially tax deductible. But you must itemize deductions, and you can deduct eligible medical expenses only to the extent that they exceed 7.5% of your adjusted gross income.

If your COBRA coverage is for a high-deductible health plan or you purchase bronze-level coverage on the Marketplace, you can make tax-deductible contributions to a Health Savings Account — and you don't have to itemize to claim the deduction. HSA withdrawals used for qualified medical expenses are tax-free.

Retirement savings

Do you have a retirement plan with your former employer, such as a 401(k) plan? You may be able to leave the account there. But consider the investment options it offers and the fees that will apply.

If you get a new job, you may want to roll over the funds to your new employer's 401(k) plan. That will leave you with fewer retirement accounts to keep track of. But again, consider the investment options and fees of the new plan.

In many cases, a direct, tax-free rollover from your old 401(k) to an IRA is the best move. You'll generally have a much wider variety of investment options and more control over fees because you choose the brokerage firm, bank or other IRA custodian.

If you're doing a rollover, request a direct rollover from your old plan to your new plan or IRA. Otherwise, you'll need to make an indirect rollover within 60 days to avoid tax and potential penalties.

If you make withdrawals from your former company's plan or IRA to supplement missing income, you'll generally owe income tax on them. And, if you're under age 59½, you'll owe an additional 10% penalty unless you qualify for an exception. (If you have a Roth IRA, you can withdraw up to your contribution amount without incurring taxes or penalties.)

If a distribution from your former employer's retirement plan includes employer securities in a lump sum, the distribution is taxed under the lump-sum rules — except that net unrealized appreciation in the value of the stock isn't taxed until the securities are sold or otherwise disposed of later.

Further, any loan you've taken out from your former employer's retirement plan, such as a 401(k)-plan loan, may be required to be repaid within a specified period or even immediately. If it isn't repaid, it may be treated as if the loan is in default. If the balance of the loan isn't repaid within the required period, it will typically be treated as a taxable distribution.

Guidance available

A job loss can create tax consequences that aren't always obvious. Reviewing your options before making decisions about severance, health coverage or retirement accounts may help you avoid unnecessary taxes and penalties. If you'd like guidance, contact us.