

How to Make Filing Your 2020 Returns Less Taxing

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Unquestionably, 2020 was a year full of unforeseen challenges. As much as we may want to put last year completely behind us, we need to file our 2020 tax returns before completely letting go. Although we speak about the challenges and frustrations of the past twelve months broadly, a few specific events will present unusual tax considerations for some Americans.

Taxation of Unemployment Compensation Income

More than 25 million Americans became unemployed during the pandemic and relied on unemployment benefits. Unemployment benefits are includable in gross income and, therefore, are subject to tax. This may come as a surprise, especially to the thousands of Americans who applied for unemployment benefits for the first time this year. Withholding tax from one's unemployment income is voluntary through the completion of a form referred to as a W-4V and submission to the agency paying the benefits. If their withholding amount is too low to cover their tax liability or if they did not authorize withholding, taxpayers can make quarterly estimated tax payments. Given the economic instability and uncertainty we are experiencing, many taxpayers relying on unemployment benefits are unlikely to have the financial wherewithal to withhold any portion of that income. Even worse, they may have no means available to pay the tax when due. If they were unaware of the tax impact when receiving unemployment benefits, they should be prepared for the unexpected tax now.

Home Offices

On the flip side of the employment coin, another tax quirk created by the COVID-19 pandemic comes in the form of working from home. Many taxpayers spent time working from home last year (and some of us still are!). Had this pandemic occurred before the 2017 enactment of the Tax Cuts and Jobs Act ("TCJA"), millions of Americans would be eligible for a deduction for expenses incurred creating and operating a home office. However, the TCJA limited deductions for home office expenses to those who are self-employed and whose home office areas are a "room or separately identifiable space" used "regularly and exclusively" for work. Thus those of us who have properly designated home offices as a result of the pandemic that might otherwise qualify, but receive W-2s as employees are ineligible for such deductions.

CARES Act

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Similarly, many Americans received government aid in the form of stimulus checks through the CARES Act. These payments are tax-free and are not required to be included in gross income on one's federal tax return. Rather, they are treated as advances of 2020 tax credits and must be reflected that way on our 2020 tax returns. Some tax professionals anticipate many taxpayers will have discarded or misplaced documentation related to those distributions, which, in turn, increases the likelihood that returns will be inaccurate, which may delay refunds. Additionally, some tax professionals have recommended that the IRS setting up an online portal for taxpayers to look up the exact amounts they received in government aid under the CARES Act to ensure their 1040s are accurate, but no such portal has been created as of the writing of this post. Thus, it is important for taxpayers to locate and organize their documentation relating to any stimulus check payments.

PPP Income

On top of these challenges presented to individuals filing their 2021 tax returns, some businesses face the uncertainty of whether business expenses paid for with loans received from the Paycheck Protection Program (PPP) will be wholly or partially deductible on their 2020 returns. Under the PPP, certain small businesses whose operations were directly impacted by the COVID-19 pandemic were able to secure loans to fund specified expenses, including eligible payroll costs, payments on business mortgage interest payments, rent and utilities during a period of 8 or 24 weeks after disbursement. Borrowers may apply for forgiveness of these loans within 10 months of their issuance, to the extent they are used for these purposes in the year the expenses are incurred. It was unclear under the original CARES Act whether the expenses paid with the forgiven loan proceeds would be deductible. In December 2020, Congress passed the Consolidated Appropriations Act, which finally clarified that business expenses paid with forgiven PPP loans are, in fact, tax deductible. This act supersedes prior guidance from the IRS, issued as recently as November 2020. While this came as a welcomed holiday gift to many, there may be S corporation shareholders and partners in partnerships with a lump of coal thrown in; the benefit may be somewhat less timely than anticipated given the quirks of pass-through entity taxation, effectively deferring the tax benefit another year.

Carefulness has always been key when completing a tax return, but even more so when filing returns for tax year 2020. Any taxpayer who received a stimulus check should start looking for that piece of paper now — tax time will be here before you know it! As the COVID-19 pandemic persists while we await widespread distribution of the vaccine, the IRS has emphasized the need for taxpayers to complete their tax returns from the safety of home, and provides a number of services to assist taxpayers in doing so. If you encounter any legal issues regarding your taxes, Flaster Greenberg can help; give us a call.

For more information on any of the information contained in this post, contact any member of Flaster Greenberg's Taxation Practice Group.

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