COUTO DEFRANCO, P.A.
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

ONLINE ADVISOR

October 2020

Does your monthly income seem a little higher than normal? If so, that may actually be a sign of trouble ahead. Find out how a tax trap could be lurking in your paycheck. Also read about your options for what to do with your 401(k) when switching jobs.

Please call if you would like to discuss how this information could impact your situation. If you know someone who can benefit from this newsletter, feel free to send it to them.

Upcoming dates:

How to Build Your Emergency Fund - When You Have No Money

This year's pandemic highlights the importance of having enough money set aside in an emergency fund to cover six to nine months of key expenses should you lose your job.

But how do you build an emergency fund if you don't have any extra money? The easiest way to accomplish this is by reducing your expenses. Here are some creative ways to increase your cash flow by cutting your spending.

How much you need
First, determine how much of an emergency fund you need. Identify the essential monthly bills and multiply by the number of months of funds you'll need. At minimum include the following:

- Food
- Housing costs, including rent or mortgage payments
- Medical insurance
- Transportation
- Phone service and other utilities

Ideas to fund your emergency account

- **Temporarily suspend nonessential monthly expenses.** Ditch your $150 cable bill for a $20 streaming service. Cook your meals from scratch instead of purchasing pre-packaged food. Eliminate or re-think your entertainment spending. Until you get your emergency fund fully funded, consider less expensive alternatives for items you normally purchase.
- **Radical cutbacks for a set period of time.** Can your family live with one car instead of two? Instead of downsizing from cable to a streaming service, what about getting rid of television subscription fees altogether? Consider if there

October 15
- Extension deadline for individual and C corporation tax returns

October 31
- Halloween

Is a Tax Trap Lurking in Your Paycheck?

Does your paycheck look a little higher than normal? If so, it could be a tax trap.

The Problem
A payroll tax deferral beginning September 1 was recently signed via a presidential executive order. This deferral of the employee's portion of Social Security will raise your paycheck temporarily until January, 2021. Beginning in 2021, the deferred Social Security will then need to be paid.

This year's tax deferral is NOT currently a tax holiday. So even if your employer removes your Social Security tax from your paycheck, there is a real possibility you will need to pay it back between January and April, 2021. That could mean a pretty large tax bill for you in early 2021!

are areas you'd be willing to make a radical (and temporary) change to free up some cash.
- **Track your spending.** When you go on a diet, nutritionists often recommend counting calories. When going on a spending diet, consider tracking your purchases. You will quickly see items that are not essential. Spending at coffee shops, paying for multiple streaming services and paying for extra cell phone services are just a few examples. You may discover problem areas you didn't know about once you start writing down your spending in a notebook or on a spreadsheet.
- **Stick to a shopping list.** Avoid impulse purchases by making a list of items you need to purchase, then sticking to the list. At the beginning of every month, write down the household items you need to purchase that month and do your best not to deviate from it. You can use this strategy with both in-person and online shopping. Remember, merchants are scientists when it comes to tempting you with impulse purchases.

You may need to get creative with your approach, but finding the money to build your emergency fund is essential, now more than ever.

As always, should you have any questions or concerns regarding your tax situation please feel free to call.

Switching Jobs? Here's What To Do With Your 401(k)

Suppose you're switching jobs if you were furloughed because of the pandemic or you're simply searching for greener pastures. If you have a 401(k) from your soon-to-be former employer, you must decide what to do with your retirement account when you leave. Here are your four options:

What you need to do

- **Compare paychecks. If you are unsure whether your employer is participating in the tax deferral, get your last paycheck from August and your first paycheck from September. Compare the amount of Social Security and other taxes withheld from your August paycheck to your September paycheck. If the amounts are the same, then your Social Security and other taxes are still being withheld.**

  If you notice that the amounts are different, or that no Social Security taxes are withheld from your September paycheck, then that's a signal you may have a tax repayment bill in early 2021.
- **Remember to keep checking each paycheck. Companies are struggling to figure out if they are required to comply with the presidential executive order, payroll providers are trying to figure out how to comply, and everyone is wondering whether the tax obligation will be permanently forgiven. So you will need to keep checking your paycheck throughout the balance of 2020.**
- **Be prepared to pay it back. If taxes have been deferred from your paycheck through the end of 2020, be prepared to have your paycheck withholdings increase substantially beginning in 2021. If possible, open a savings account to set aside the taxes that were not withheld from your paychecks. When it comes time to pay your taxes, you will have funds to weather the repayment storm.**
- **Check back here for updates. There's a chance Congress passes a law that forgives the deferred taxes. If this happens, you will have a nice start on an emergency fund should you need it.**

- Leave the money in your previous employer’s pension plan.
- Roll over the money to your new employer’s pension plan.
- Roll over the money into an IRA.
- Take the money and run.

So which of these options should you choose? Here are some things to consider as you think about what to do with your 401(k) account:

Keep the borrowing option open. If you want to borrow money from your employer-sponsored 401(k) account in the future, consider rolling the money into your new employer's 401(k) plan. While you can borrow money out of your 401(k), that option is not allowed with an IRA. And if you leave your 401(k) at a former employer, they often will not let you borrow funds if you are not currently employed.

Take the money. This year may be the best time to make a withdrawal from a retirement account. In a normal year, when you make an early withdrawal from a retirement account, you owe income taxes on the amount of the distribution plus a 10% early withdrawal penalty. In 2020, this 10% penalty has been suspended. So while you’ll still pay taxes on the distribution, you may be able to avoid the early withdrawal penalty.

Invest the money. While it might be tempting to borrow or take an early distribution from your retirement account, you’ll also be depleting future earnings intended for your retirement years. So consider whether you truly need the money now to pay for an emergency or if you’re ok leaving it in your 401(k).

Whatever you decide, it is always best to transfer the funds directly from one retirement account to another. This direct transfer eliminates the possibility of your fund movement being characterized as a distribution subject to income tax. If in doubt, ask for help.

If you have any questions about how this payroll tax executive order affects you, please call.