Nagel on Finances: Unexpected tax consequences

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RIO RANCHO, N.M. — Despite all the debate, committee hearings, drafting and re-drafting, despite the spirit and intent of Congressional will, tax laws get signed into action with unintended consequences.

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Since March of last year, thousands, if not tens of thousands, of pages of COVID relief legislation have become law. Generally, as the word "relief" implies, intended benefits were directed to economic conditions brought on by the pandemic; for example, benefits to retain employment.

Generally, the intended benefits have achieved good things.

But now, as we move through yet another disrupted income tax filing season, tax preparers and advisors nationwide are beginning to discover unexpected tax consequences of COVID-19 and COVID relief legislation.

If you are self-employed or own a small business, you know what I am talking about. You know this because you are disciplined.

You monitor your monthly operating activity against plans by evaluating your monthly financial statements and budget variance reporting. You have reserved sufficient cash to pay the additional tax you otherwise did not expect to owe.

But, if you took your eye off the ball, or simply couldn't bring yourself to look at any more bad news, it is time to pay up.

In 2017, the Tax Cuts and Jobs Act attempted to reduce deductions for business meals and entertainment. After the devastating impact of COVID-19 on the restaurant and hospitality industry, the Consolidated Appropriations Act was signed into law Dec. 27, 2020, loosening up those laws, reviving deductions closer to what they had been before 2017.

But guess what? Restaurants were closed. Seminar and convention business went online.

Self-employed people and other businesses simply did not spend that money, so taxable income has increased. Besides, the law passed too late in the year to affect 2020. That's an unexpected consequence.

Those of us who regularly drive our personal automobiles for business purposes are faced with a similar unexpected consequence of COVID-19. The current rule for mixed-use assets like automobiles allows for accelerated depreciation in the year of acquisition if that mixed-use asset was used 50 percent or more in business.

You all know that business use does not include commuting to your office, store or warehouse from your home. That's commuting miles.

But where did you drive in 2020 on business? We couldn't meet. We "Zoomed."

Chances are what would have been more than 50 percent use is substantially lower. That reduces potential deductions.

So, you weren't self-employed? These unexpected consequences may affect your household, as well.

Do you have school-age children or preschoolers who normally attend a day care, even if only after school? Fortunately, current tax law allows for up to $5,000 of pre-tax income to be set aside for a day care allowance in a Dependent Care Flexible Spending Account.

Unfortunately, you know that FSA is a "use it or lose it" benefit. If you did not spend that money on day care, you get to pay tax on the unused amount. Worse, you don't get your money back.

Did your kids go to day care or stay home for online learning? Or did they go to grandma's house?

Grandma may be happy, and you may have saved a little day care money, but you will likely have some tax to pay.

If you had to draw on your 401k or IRA to cover living expenses while your employer was shut down, you may be forced to pay taxes and penalties.

Here's some good news.

If the Tax Reform Act of 1986 is any indication, regulations interpreting recent COVID Relief tax laws will not be decided and published for years to come. Major consequences might get reversed at a later date.

Better yet, well-informed advisors often know of actions to mitigate unexpected consequences like the day care and 401k examples above.

Get professional advice before time runs out and deadlines pass.

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