American Rescue Plan Act

Implications for Tax Years 2020 & 2021

Introduction:

2020 is long gone but our lawmakers must be stuck in the past because they changed the 2020 tax rules… *during filing season!*

Page 1 of this newsletter covers how the American Rescue Plan Act (ARPA) affects your 2020 tax return. Page 2 covers the key provisions of ARPA for tax year 2021. Most of the 2021 tax provisions are 1-year only (2021 only). As such, don't use this newsletter for long-term planning. Rather, take advantage of what you can for 2021 and wait to see if Congress passes an extenders bill to stretch the provisions into future years.

Tax Year 2020 Implications:

Good news! None of the 2020 provisions in ARPA will increase your tax… they will only result in owing less tax if you are affected by the new law.

Unemployment Compensation

Unemployment compensation for some taxpayers will be partially excluded from taxable income.

If your 2020 modified Adjusted Gross Income (not including unemployment compensation) was $150,000 or more then you don't qualify and can't claim the exclusion. Everyone else can exclude up to $10,200 of unemployment compensation from taxable income.

For example, a qualifying taxpayer that received $20,000 in unemployment can exclude $10,200 of it (thus reducing the taxable part to $9,800). Qualifying taxpayers that received less than $10,200 in unemployment can only exclude the amount of unemployment they received (not the full $10,200).

If your spouse also received unemployment they too can exclude up to $10,200 on a jointly filed return. But don't forget, you can't claim the exclusion if your modified AGI is $150,000 or more. In such circumstances, married taxpayers may want to consider filing separately to claim the exclusion. However, ask for help before doing this because the downside of filing separately may be greater than the upside of claiming the unemployment exclusion.

To assist taxpayers, the IRS created a new worksheet called the Unemployment Compensation Exclusion Worksheet. The worksheet is confusing and qualifying taxpayers should ask for help.

Do Not Amend your 2020 Return to Claim the Unemployment Exclusion

There is no need to amend an already filed return to claim the unemployment exclusion. As of 3/23/21, the IRS website states that they will issue direct refunds to taxpayers who already filed. If your original 2020 refund was direct deposited the IRS will likely direct deposit the additional ARPA refund. If you had a balance due then they will likely send the ARPA refund as a paper check (to the address listed on the return).

Premium Tax Credit Repayment Relief

More good news! Taxpayers that purchased health insurance on healthcare.gov (or their state-run insurance exchange) in 2020 and received advance payments of the Premium Tax Credit will not have to repay the excess on their 2020 tax return. This is true even for taxpayers with incomes over 400% of the federal poverty level (which previously was the threshold for having to pay-back 100% of the advance payments).

For taxpayers that have already filed a return the IRS website says **do NOT file an amended return**. Presumably, they will issue direct payments to affected taxpayers (similar to what they are doing for the unemployment exclusion).

The IRS has not provided guidance about how to remove the excess repayment on 2020 returns (as of 3/24/21). In time, they will create a way to remove the tax (which currently displays on line 29 of form 8962 and line 2 of Schedule 1). In the meantime, affected taxpayers may want to hold-off on filing until closer to the extended May 17th filing deadline (see next section).

Extension of Time to File and Pay

Thankfully, the IRS is giving everyone extra time to deal with these changes. They have officially extended the 2020 tax filing and payment deadline to May 17. The deadline extension was not technically part of ARPA (but it likely was necessitated by it).

Note: The extended tax deadline pertains to 2020… so 2021 first quarter estimated tax payments are still due on 4/15/21 (of course, this doesn't pertain to you if you pay all your tax via withholding and don't make quarterly estimated tax payments).

These are the key provisions of ARPA affecting 2020 filings and payments.
Turn the page to learn more about how ARPA will affect tax year 2021.

2021 Tax Provisions:

ARPA is a big & bold tax bill. Here are the highlights that will affect the greatest number of folks.

More Stimulus Payments

The ARPA stimulus payments are more generous than the previous two rounds of stimulus in that:

- The dollar amount per eligible taxpayer increases to $1400.
- The dollar amount per eligible dependent increases to $1400. Similar to the first rounds, the taxpayer gets the dependent's stimulus (not the dependent).
- All dependents regardless of age now qualify.

The stimulus begins to phase-out at the same income thresholds as the previous rounds (AGI of $75000/$112500/$150000, Single/HH/MFJ). However, the ARPA stimulus completely phases-out at an AGI of $80000/$120000/$160000 (single/HH/MFJ). The previous two rounds phased out slower and taxpayers with AGI greater than $80k/$120k/$160k could still get partial stimulus payments.

The ARPA stimulus payments have already started. The IRS is using data from the most recently filed return to base the payments. If you haven't filed your 2020 return then 2019 will be used to calculate the payment.

Other details regarding the ARPA stimulus are similar to the previous rounds, including but not limited to:

- Keep track of how much you receive because you will need it when filing your 2021 tax return. If you were underpaid you may be able to claim a tax credit on your 2021 return.
- You will not have to repay the stimulus on your 2021 tax return. This is true even if your situation changed in 2021 (e.g. making more money or claiming fewer dependents).
- If you can be claimed as a dependent then you do not get the stimulus. This is true even if nobody claims you. However, if 2021 is the first year that nobody can claim you as a dependent then you can claim a tax credit on your 2021 tax return (only if you qualify, of course).

Enhanced Child Tax Credit

ARPA increases the Child Tax Credit (CTC) from $2000 (per dependent age 0-16) to $3600 (dependents age 0-5) or $3000 (dependents age 6-17). The new CTC begins to phase-out at the following 2021 AGI thresholds:

- Single: $75,000*
- Head of Household: $112,500*
- Married Filing Jointly: $150,000*

* For every $1000 of AGI above these levels the credit is reduced by $50. However, it will not go below $2000/dependent until AGI exceeds $400,000 (MFJ) or $200,000 (Single/HH/MFS).

ARPA also makes the CTC fully refundable, which means you can claim it even if you don't have tax liability or earned income. Previously, the CTC was only refundable up to $1400 per dependent (and limited based on a percentage of earned income).

Additionally, ARPA allows taxpayers to begin receiving the enhanced CTC in 2021 rather than waiting to file the 2021 tax return. The IRS has not finalized details about exactly how this will work. In time, they will create an online portal to coordinate these payments. CTC advance payments may have to be paid-back on the 2021 tax return if the taxpayer receives too much. This is true for all taxpayers whose AGI is over $80000/$100000/$120000 (single/HH/MFJ). Taxpayers whose AGI is less than $40000/$50000/$60000 (single/HH/MFJ) will not have to pay-back any overpayments. Taxpayers between those thresholds will have to pay-back a portion of the overpayment.

Enhanced Daycare Credit

ARPA dramatically enhances the Child and Dependent Care Credit. The new law increases the expenses that qualify for the credit from $3000 to $8000 per qualifying child under 13 years of age ($16000 if you have two qualifying children).

ARPA also increases the percentage of daycare expenses that count for the credit (if your AGI is under $400,000).

Combined together, the increased expense limit PLUS credit percentage makes a big difference for many middle income taxpayers. For example, the credit jumps from $1200 to $8000 (if you make less than $125,000 and have two qualifying kids in daycare at a combined cost of over $16000).

ARPA also increases the amount that you can contribute to a pre-tax dependent care flexible spending account from $5000 up to $10,500. As was the case before, contributions to the pre-tax account reduce the qualifying expenses for the credit (and thus reduce the credit).

Enhanced Premium Tax Credit (affects both 2021 & 2022)

Great news for folks who buy insurance on healthcare.gov (or their state-run exchange). Taxpayers that make greater than 400% of the federal poverty level may not have to pay-back 100% of the advance payments of the Premium Tax Credit. This solves a big problem for middle income taxpayers that could not precisely control their income (to keep it below the 400% FPL threshold). Now they can earn more and potentially pay-back less than 100% of the subsidy.

Additionally ARPA reduces the percentage of household income that taxpayers with marketplace coverage must rightfully pay toward health insurance. This is complicated but it means that they qualify for a higher Premium Tax Credit.

Enhanced Earned Income Tax Credit

ARPA helps more taxpayers without children qualify for the Earned Income Tax Credit (EITC). That's because it reduces the age where 'childless' taxpayers can claim the EITC (from age 25 down to 19). The new law also eliminates the upper age limit for 'childless' EITC claimants.

ARPA also allows some legally married taxpayers that file separately to claim the EITC. This is now allowed only in the case where the married couple lives apart for the last half of the year and the qualifying child lives with the taxpayer claiming the EITC for greater than half the year.

Lastly, ARPA increases the investment income threshold for the EITC to $10,000. Previously, if your investment income was greater than $3650 you could not claim the EITC.

These are just a few of the tax provisions in ARPA. Ask for help to learn more.