Additional Supplement for the American Rescue Plan Act of 2021

J.K. Lasser's Your Income Tax 2021
J.K. Lasser's Small Business Taxes 2021
J.K. Lasser's 1001 Deductions and Tax Breaks 2021

The American Rescue Plan Act of 2021, which was signed into law on March 11, 2021, is a new stimulus measure (P.L. 117-2). It provides a third round of Economic Impact Payments (EIP3) and makes many other tax changes. While most of the changes apply for 2021, some may affect your 2020 return (whether or not it's already been filed) and some may apply for years after 2021. The following is a brief overview of the key changes impacting individuals and a list of key changes for businesses. Keep in mind that the IRS is continuing to provide guidance on these changes in the months ahead; visit *JKLasser.com* for updates.

Economic impact payments

Eligible individuals receive up to $1,400 in stimulus payments (called EIP3). The payment amount is the same for taxpayers as well as their dependents, including children 17 and older and adult dependents. For most, payments are made via direct deposit into bank accounts. EIP3 is not includible in gross income.

The amount you receive depends on your adjusted gross income (AGI) in 2020 if you already filed your 2020 return (or 2019 AGI if the 2020 return has not yet been filed). EIP3 is tax free. Full payment applies if your AGI is no more than $75,000 if single or married filing separately, $112,500 for a head of household, and $150,000 if married filing jointly or a qualifying widow/widower. EIP3 is reduced as AGI increases; no payment is made if AGI is $80,000 or more if single or married filing separately, $120,000 or more if head of household, or $160,000 or more if married filing jointly or a qualifying widow/widower.

Note: EIP3 is not reduced by any outstanding federal taxes. However, when the payment is reconciled on the 2021 return, which may entitle individuals to larger payments in the form of a Recovery Rebate Credit, offsets for federal income taxes and certain other debts (e.g., delinquent federal student loans; certain delinquent child support payments) are permissible.

Unemployment benefits

For those who are unemployed, there is a federal benefit of $300 per week from March 14, 2021, through September 6, 2021. This is in addition to state unemployment benefits. All benefits received in 2021 are taxable, so if you want voluntary withholding from benefits, complete Form W-4V to start 10% withholding of federal income tax.

For those who received unemployment benefits in 2020, up to $10,200 is tax free (and not taken into account in figuring AGI), as long as adjusted gross income is less than $150,000. If you haven't yet filed your 2020 federal income tax return and plan to do so on paper, look for a new worksheet to line 7 of Form 1040 or 1040-SR. If you file electronically, software reflects this law change. If you have already filed your 2020 return…on paper or electronically…do not file an amended return. The IRS will make adjustments and, where applicable, send refunds.

Caution: Be sure to check for your state's tax treatment of unemployment benefits to *see* if it conforms with this tax break.

Child tax credit

For 2021 only, the credit amount is increased significantly and depends on the age of the qualifying child. Instead of the usual $2,000 credit amount, it is $3,600 for a child from birth to age 5 and $3,000 from age 6 through age 17 (one year more than for 2020). The full credit is refundable.

There is a two-stage phaseout for the 2021 credit based on AGI:

- *Stage one:* The credit amount above $2,000 is reduced and phases out when AGI exceeds $75,000 for singles and married persons filing separately, $112,500 for heads of households, and $150,000 for married persons filing jointly and qualifying widows/widowers.
- *Stage two:* The balance of the credit ($2,000) is reduced and phases out when AGI exceeds $400,000 for married persons filing jointly or $200,000 for all other filers.

Starting July 1, 2021, the IRS is supposed to begin sending one-half of the anticipated credit for 2021 in equal periodic payments (probably on a monthly basis). You can elect not to receive payments in advance, although there is no tax reason to do this. The credit will then be computed on the 2021 return and reconciled with advance payments. There is a safe harbor protecting lower income taxpayers from repayments if a final computation of the credit is less than the advance payments received.

Earned income credit

Some changes to the credit apply only for 2021, while others are permanent. On the 2021 return, you may elect to use your 2019 earned income to figure the credit if it is higher than in 2021. But you must still use 2021 adjusted gross income and other amounts in figuring the credit.

Investment income over threshold amount disqualifies you from claiming the credit.For 2021, the threshold is $10,000 (up from the $3,650 it was supposed to be). The $10,000 threshold will be adjusted for inflation after 2021.

For 2021 only, the credit has been expanded for a taxpayer with no qualifying children. The minimum age for eligibility is reduced from 25 to 19 (24 for full-time students; 18 for former foster children and homeless youths. The maximum age of 65 does not apply. The earned income limit and percentage for figuring the credit are increased so that the maximum credit for 2021 is $1,502 (it was supposed to be $543). The phaseout threshold is also increased.

Starting in 2021, married persons may be treated as unmarried for purposes of claiming the earned income credit if a qualifying child lives with them for more than half the year and they (1) live apart from their spouse for the last six months of the year or (2) have a support decree, instrument, or separation agreement and are not living with their spouse by the end of the year. Individuals with a qualifying child who does not have a Social

Security number may claim the earned income credit as if they were without a qualifying child.

Note: The change to the tax treatment of 2020 unemployment benefits (up to $10,200 of benefits are tax free if modified adjusted gross income is less than $150,000) may mean a change in the earned income tax credit for 2020. If you claimed the credit, the IRS will automatically adjust it upward if applicable due to the change. However, if you already filed your 2020 return but did not claim the credit because your income, which included the $10,200 of unemployment benefits, was too high, you need to file an amended return to claim the refundable tax credit.

Dependent care credit

The child and dependent care credit (referred to as the dependent care credit) is greatly enhanced for 2021 only. The amount of qualified expenses on which the credit is based increases to $8,000 for one qualifying child and $16,000 for two or more qualifying children (in 2020 it is $3,000 and $6,000, respectively). The maximum credit rate is increased to 50% (up from 35% in 2020). The credit is fully refundable in 2021.

However, the credit phases out in three stages:

- ***Stage one:*** The maximum credit applies to those with AGI up to $125,000.
- ***Stage two:*** The 50% rate declines to 20% for AGI up to $185,000 (it stays at 20% for those with AGI up to $400,000.
- ***Stage three:*** The rate phases out for AGI up to $440,000. While high-income individuals may claim a 20% credit in 2020, they get no credit in 2021 once AGI reaches $440,000.

Premium tax credit

For 2020, you do not have to reconcile advance payments with your actual credit. Any excess is not treated as tax liability. If you already reconciled the credit on your 2020 return that was filed, wait for IRS instructions about getting a refund.

For 2021 and 2022, those with household income over 400% of the federal poverty level may claim the premium tax credit. The required contribution toward insurance premiums is reduced to a range of zero to 8.5% of household income (down from the 2020 range of 2.06% to 9.78%). And anyone receiving unemployment benefits in 2021 may qualify for the credit and is eligible to enroll in the government Marketplace starting April 1, 2021.

There is a special enrollment period (SEP) starting April 1, 2021, during which you may change plans and lower your premiums for 2021. Find more information from CMS.gov at https://www.cms.gov/newsroom/fact-sheets/american-rescue-plan-and-marketplace.

Employee benefits

You may be eligible for various employer-provided or sponsored benefits, including:

- ***Paid sick leave and paid family leave.*** Small employers, those required to provide such compensation in 2020 to employees impacted by COVID-19, may offer such pay to employees through September 30, 2020.
- ***Dependent care assistance plans.*** If your employer offers this benefit, either as a salary reduction option through a cafeteria plan or pays for benefits on your behalf, the tax-free limit for 2021 is $10,500 (up from the usual $5,000 limit). If you have carryovers of unused benefits from 2020, this allows you to use them up in 2021 on a tax-free basis. Note: Employers are not required to raise the limit (it's voluntary), so check with your plan administrator.

- *COBRA coverage.* Those who are involuntarily terminated now from a company with at least 20 employees and a group health plan can obtain continued health coverage at no cost. The employer must pay for coverage from April 1, 2021, through September 30, 2021. The employer claims a tax credit to cover this cost.

Student loan forgiveness

When student loans are canceled, discharge of indebtedness income generally results (there are exceptions for certain student loans). However, for 2021 through 2025, most student loans that are canceled will not trigger taxable income. The new law does not forgive student loans; it merely provides the tax treatment if such loans are forgiven.

Tax changes for businesses

The changes impacting businesses are not as extensive as those for individuals. Some changes affect self-employed individuals, as noted below.

- *Tax treatment of certain federal financial assistance programs.* Like the tax-free treatment that applies to the forgiveness of loans under the Paycheck Protection Program (PPP), the $10,000 advance under the SBA's Economic Injury Disaster Loan (EIDL) program, and grants to shuttered venue operators, similar treatment applies to targeted EIDL advances and grants from the Restaurant Revitalization Program. Expenses covered by these funds are tax deductible under usual rules.
- *Employee retention credit.* The credit for keeping an employee on the payroll despite a business closure or substantial cutbacks was supposed to expire on June 30, 2021, but has been extended through December 31, 2021. Severely-stressed businesses (those that experience a 90% drop in gross receipts compared to the corresponding quarter in 2019) can treat all

employee wages as qualified. What's more, a recovery start-up business, which is one that was set up after February 15, 2020, may claim a credit of up to $50,000 per calendar quarter as long as annual gross receipts don't exceed $1 million. The credit can be used to offset the employer's share of Medicare taxes (part of FICA) starting July 1, 2021.

- ***Paid sick leave and paid family leave credits.*** These credits, which were supposed to expire on March 31, 2021, have been extended through September 30, 2021. The family leave credit may now be up to $12,000 in wages per employee (an increase from the former $10,000 limit). These credits can also be used to offset the employer's share of Medicare taxes (part of FICA). Self-employed individuals impacted by COVID-19 may claim equivalent income tax credits.
- ***COBRA subsidy credit.*** Employers paying COBRA coverage for involuntarily terminated employees as discussed above may claim a tax credit against the employer's share of Medicare taxes. But this credit is reduced by other offsets to Medicare taxes for the employee retention credit and the paid sick leave and family leave credits. Employers must provide notice to eligible workers as well as notice of when the subsidy ends. Failure to do so may result in a penalty on employers. The IRS promises model notices that can be used for these purposes.
- ***Excess business losses of non-corporate taxpayers.*** Owners of pass-through entities, as well as sole proprietors, who have business losses over a threshold amount may not deduct them currently. Instead, the excess losses become part of their net operating losses. This rule, created by the Tax Cuts and Jobs Act, was suspended for 2018, 2019, and 2020. It takes effect in 2021. It was supposed to expire after 2025, but the new law extends it through 2026 in order to raise revenue.

- ***Form 1099-K reporting.*** Third-party settlement organizations, such as banks and PayPal, that process credit/debit card payments and electronic transfers currently must report to the IRS if there are more than 200 transactions for goods and services totaling over $20,000. Starting in 2022, reporting is required for transactions of $600 or more for any payee, such as gig workers who receive payments through an online platform.

Tax filing and tax payments

Due to the continued issues triggered by the pandemic, the IRS extended the filing deadline for 2020 federal income tax returns for individuals to May 17, 2021. State filing deadlines may or may not conform to the federal deadline. Any unpaid 2020 federal taxes will not begin to accrue interest until May 17, 2021. This extension also applies to making contributions for 2020 to IRAs and health savings accounts. The federal extension was not allowed for the first installment of estimated tax for 2021, which remained due on April 15, 2021.

Additional guidance

Continue to monitor *JKLasser.com* and IRS.gov for any further relief and guidance.

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