BAIRD
Private Wealth Management

# The American Rescue Plan Act of 2021

## An Overview of the Tax-Related Provisions

The latest COVID relief bill issues a third, more targeted, round of stimulus payments to qualified individuals and enhances the available tax breaks to low-income families and small businesses.

**Financial & Estate Planning Department**
Baird Private Wealth Management

March 2021

The $1.9 trillion economic stimulus package initially proposed in mid-January has officially been passed into law. After several modifications were made to the bill, including the removal of the minimum wage provision, the American Rescue Plan Act of 2021 was passed by the Senate in a 50-49 vote, and subsequently signed by President Joe Biden on March 11, 2021. The bill allocates funds to state and local governments, schools, COVID-19 testing and vaccination programs, small business programs and various other industries significantly impacted by the pandemic. The bill also expands on many of the measures provided in the CARES Act and Consolidated Appropriations Act, 2021 (CAA), benefiting small businesses and low-income families.

### RECOVERY REBATES

The CARES Act, passed in March of 2020, provided for the first round of stimulus payments. In December of 2020, a second round of stimulus payments were negotiated. Many lawmakers, including former President Trump and President-Elect Joe Biden, were pushing for a $2,000 payment, however, only $600 was ultimately included in the CAA. As expected, the recently enacted American Rescue Plan Act of 2021 includes a third round of stimulus payments amounting to $1,400 per qualifying individual. This includes both adults and children, meaning a family of four could receive up to $5,600. Unlike the previous rounds, adult dependents, including college students and older adults, are considered eligible dependents and can therefore add another $1,400 to the household total. The amount received will be based on the taxpayer's 2020 tax return, however, the 2019 return will be used if a 2020 return has not been filed. For social security recipients who are not required to file a return, the rebate will be based on the individual's 2020 social security information pulled from Form SSA-1099 or Form RRB-1099, in the case of railroad retirement benefit recipients. This round of stimulus payments will phaseout quicker than the previous two rounds. Taxpayers will receive the full amount if adjusted gross income is at or below $150,000 for joint returns, $112,500 for head of household returns, and $75,000 for single returns. The payment is fully phased out at an AGI of $160,000 or more for married filers, $120,000 or more for head of household filers and $80,000 or more for single filers. For example, assume married couple Doug and Sue have a 10-year-old daughter and reported $156,000 of AGI on their 2020 tax return. As a family of three, they are eligible for $4,200 in stimulus payments; however, their income is over the $150,000 threshold by $6,000. Therefore, their stimulus payment is reduced by 60% [($156,000-$150,000/($160,000-$150,000)], bringing their total stimulus payment to $1,680.

The payment is considered an advanced 2021 tax credit. Therefore, upon the filing of the 2021 income tax returns, the payment amount will be recalculated based on the taxpayer's 2021 adjusted gross income. As was the case with the previous stimulus payments, if the calculated amount on the 2021 tax return is less than the amount already received, there will be no requirement to pay back the difference. Therefore, taxpayers whose income increased in 2020 compared to 2019 may want to hold off on filing their 2020 tax returns to ensure the payment is calculated based on their lower, 2019 income. Likewise, if 2020 income is lower than 2019 and will yield a larger stimulus payment, taxpayers may want to accelerate their 2020 tax filing. If the recalculated payment based on 2021 income is larger than the amount previously received, the difference may be claimed as a recovery rebate credit on the 2021 tax return. The credit is refundable and therefore, no minimum level of income or minimum tax liability is required to receive the full credit.

## CHILD TAX CREDIT

The American Rescue Plan Act of 2021 also provides several modifications to the child tax credit currently in place. These modifications are temporary, however, and will only be effective for the 2021 tax year. Under current law, taxpayers may claim a child tax credit equal to $2,000 per child on their tax return, with only $1,400 being refundable. For 2021, the credit amount is increased to $3,000 per child ($3,600 for children under age 6) and is fully refundable. Additionally, the maximum age for children to qualify is temporarily increased from 16 years old to 17 years old. The credit is subject to two separate phaseouts. The amount in excess of the current law's $2,000 credit is phased out by 5% of the taxpayer's modified adjusted gross income (MAGI) above $150,000 for joint returns, $112,500 for head of household returns, and $75,000 for single returns. Once the excess amount is fully phased out, the remaining $2,000 is subject to the current law's phaseout thresholds (phaseout begins at $400,000 for joint filers and $200,000 for all other filers). Continuing with the previous example, Doug and Sue's 10-year old daughter makes them eligible for up to a $3,000 child tax credit; however, because their MAGI is above $150,000, that credit is reduced by $300 [($156,000-$150,000) x 5%], yielding a total credit of $2,700. The bill also directs the IRS to estimate the taxpayer's child tax credit and pay half the amount in advance periodically (ideally on a monthly basis) beginning July 1, 2021. The remainder will be received when the 2021 income tax return is filed, whereby the full credit amount can be claimed and reduced by the amounts paid in advance. Unlike the recovery rebates, child tax credits received in advance by taxpayers who are ultimately ineligible for the credit may be subject to a clawback on their 2021 income tax return. Taxpayers will be able to opt out of receiving advanced payments or provide information regarding a change in filing status that would impact the credit amount through an IRS website (not made available as of the date of this article).

## CHILD AND DEPENDENT CARE CREDIT

As with the other tax credit changes, the bill temporarily increases the child and dependent care credit for the 2021 tax year. Taxpayers that incur childcare or dependent care costs so that they can work, or look for work, may be eligible to claim the child and dependent care credit. Currently, taxpayers can claim a credit equal to 35 percent of up to $3,000 in qualified expenses ($6,000 for two or more dependents). This percentage is reduced by 1 point for every $2,000 of AGI that exceeds $15,000, not to be reduced below 20%. For example, assume Doug and Sue incurred $10,000 in childcare costs for the 2020 tax year. Up to $3,000 can be utilized in calculating the credit amount and their AGI of $156,000 would reduce their credit percentage to the minimum 20%. Therefore, they are eligible for a child and dependent care credit of $600 [$3,000 x 20%]. Under the American Rescue Plan Act, the maximum percentage is increased to 50 percent and the maximum in qualified expenses on which the credit is based is increased to $8,000 ($16,000 for two or more dependents). Like the child tax credit, the new child and dependent care credit is subject to two separate phaseouts. First, the 50 percent is reduced by 1 point for every $2,000 of AGI that exceeds $125,000. Once the additional credit amount is fully phased out, the 20% original credit percentage applies. The 20% is not reduced until AGI reaches $400,000. Once this income level is reached, the 20 percent will continue to decrease, and taxpayers will no longer be eligible to claim the credit once AGI equals $440,000. Continuing with the previous example, assume Doug and Sue again incurred $10,000 in childcare costs in 2021. Under the new bill, up to $8,000 can be utilized in calculating the credit; however, their AGI of $156,000 would reduce the 50% maximum credit percentage by 16% [($156,000-$125,000)/$2,000]. Therefore, they are eligible for a child and dependent care credit of $2,720 [$8,000 x 34%]. Under current law, the credit is nonrefundable, meaning it cannot be utilized unless the taxpayer has a tax liability, however, the credit will be fully refundable in 2021 only.

When claiming the child and dependent care credit, the maximum amount of qualified expenses on which the credit is calculated must be reduced by any employer-provided dependent care benefits excluded from income. Currently the maximum exclusion is $5,000 ($2,500 in the case of a married taxpayer filing separately); however, the bill temporarily increased this amount to $10,500 for the 2021 tax year ($5,250 for a married taxpayer filing separately).

## EARNED INCOME TAX CREDIT

The bill made several changes to the earned income tax credit (EITC) as well. The IRS previously had the 2021 maximum EITC for a taxpayer with no qualifying children at $543. The American Rescue Plan Act increased this amount to $1,502 for 2021 only. Additionally, the minimum age at which these childless taxpayers could claim the credit is reduced from 25 to 19 for the 2021 tax year, with the exception of certain full-time students.

Similar to the provision included in the CAA where taxpayers could elect to use their 2019 earned income in calculating their 2020 EITC, taxpayers can use their 2019 earned income in calculating their 2021 EITC as well, assuming their 2019 earned income was higher.

Lastly, taxpayers are disqualified from the credit once investment income reaches $10,001, as opposed to the $3,651 limitation previously in place for the 2021 tax year.

## UNEMPLOYMENT BENEFITS

Included in the CARES Act were several unemployment assistance programs which were originally set to expire at the end of 2020. The CAA extended some of these programs, including the Federal Pandemic Unemployment Compensation (FPUC) program, which provided an additional $600 in unemployment benefits per week through July 31, 2020, and $300 in unemployment benefits per week through March 14th, 2021. The American Rescue Plan Act has extended this program for a third time through September 6th, 2021. As a reminder, this is a benefit provided at the federal level and may be supplemented with benefits at the state level.

Additionally, the Pandemic Unemployment Assistance (PUA) program as well as the Pandemic Emergency Unemployment Compensation (PEUC) program have been extended through September 6th, 2021.

The other significant change included in the bill was an exemption from tax on the first $10,200 in unemployment benefits for taxpayers with AGI below $150,000, regardless of filing status. In the case of joint filers, the $10,200 exclusion applies to each spouse. Therefore, up to $20,400 can be excluded in households where AGI is below $150,000, assuming both spouses received unemployment compensation. This exemption only applies to benefits received in 2020, so unemployment received in 2021 is currently not eligible.

## FORGIVEN STUDENT LOAN EXCLUSION

Under current law, forgiven student loans are considered taxable income, unless certain conditions are met, such as death or disability of the borrower. The American Rescue Plan Act expands the exclusion eligibility to all federal student loan amounts forgiven after 2020 and before 2026 for any reason. Therefore, if a federal student loan is discharged between January 1, 2021 and December 31, 2025, the discharged amount does not need to be included in taxable income. Although not included in this bill, this provision seems to imply that broader student loan forgiveness could apply in the future.

## COBRA ASSISTANCE

For many Americans, health care coverage is provided, and signfiicantly subsidized, by their employer. In the event that a taxpayer loses or leaves employment, the Consolidated Omnibus Budget Reconciliation Act (COBRA) gives them the option to continue coverage provided by their group health plan for a limited period of time, although at a cost. Eligible individuals may be required to cover the full COBRA premium, which can be up to 102% of the cost of the plan. The American Rescue Plan Act provides a subsidy of 100% of the COBRA premiums for up to 6 months for any individual who lost health coverage due to an involuntary termination or involuntary reduction in hours. Premiums will be paid by the former employer and the cost will be reimbursed to the employer through refundable quarterly payroll tax credits. Additionally, those who lost coverage within the last 18 months but did not elect COBRA or let their COBRA lapse will have an extended window to elect coverage. The subsidy will only be available through September 30, 2021, or the date at which COBRA coverage expires (generally 18 months after coverage was lost), if earlier.

## PAYROLL TAX CREDITS

As part of the Families First Coronavirus Response Act issued March 18th, 2020, employers are eligible for a refundable credit against the employer portion of the payroll tax on qualified paid sick and family leave. This provision expired on December 31, 2020, but was extended through March 31st, 2021 by the CAA. The American Rescue Plan Act extends the provision again through September 30, 2021. Up to $10,000 in qualifying wages can be used in calculating the credit through March 31, 2021; however, the American Rescue Plan Act increased this amount to $12,000 for applicable wages paid after March 31, 2021.

The refundable Employee Retention Tax Credit, which was originally outlined in the CARES Act, was expanded by the CAA. The December bill increased the credit rate from 50 to 70 percent on qualified wages and extended the time period for which the wages qualify from December 31st, 2020 to June 30th, 2021. The bill also increased the per employee wage limitation from $10,000 per year to $10,000 per quarter and reduced the eligibility restrictions for employers. The American Rescue Plan Act extends these provisions through December 31, 2021 and expands several of the measures allowing businesses to claim an increased credit amount.

While there were several other provisions included in the American Rescue Plan Act of 2021, those mentioned above are likely to have a significant impact on lower income households and small business in the 2021 tax year. Even though many of these provisions won't appear impactful until the 2021 tax filing season, taxpayers should begin the discussions with their tax advisors now to ensure they are taking advantage of these tax savings opportunities where possible. A full copy of the bill can be found on Congress.gov.