FEATURE

$1.9 Trillon American Rescue Plan Act Continues the Pattern of Stimulating the Economy Through Tax Policy

By Don Carpenter and Tim Thomasson

President Joe Biden signed the American Rescue Plan Act of 2021 (ARPA) into law on March 11. Positioned as a necessary financial relief package to aid families disadvantaged by the economic fallout of the pandemic, several major provisions distribute the benefits through changes in tax policy and administration.

This is consistent with the earlier relief contained in the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 and the Consolidated Appropriations Act of 2021. And although some of the provisions are similar to provisions in these earlier acts, there are modifications that are worth noting.

Recovery Rebates

Likely the most notable provision in the ARPA is the $1,400 economic impact payment to qualified individuals. The impetus for this payment is consistent with the motivations behind the earlier $1,200 payments in the CARES Act and the $600 payments made earlier this year under the Consolidated Appropriations Act. However, significant changes have been made. While this third payment provides a more inclusive definition of a dependent, the income threshold qualifications are more restrictive in response to objections by some senators.

Phase-out of the payment for single taxpayers begins with AGI of $75,000, with complete phase-out at $80,000. Phase-out ranges for married taxpayers and heads of household are $150,000 to $160,000 and $112,500 to $120,000 respectively.

Individuals who are claimed as dependents by another taxpayer are not eligible for direct payment, but the taxpayer who claims the dependent should receive the full $1,400 for each dependent claimed on their return. The prior bills defined dependents as children age 16 or younger and provided reduced amounts for these dependents. Now any dependent with a Social Security number is included in the calculation.

A major revision from the earlier payments relates to mixed-status households. In the current round of distributions, both spouses receive $1,400 if either spouse has a Social Security number. Prior payments required each spouse to have a Social Security number. Further, the ARPA makes clear that incarcerated individuals also qualify for the recovery rebate. This conforms to court decisions on the earlier rebates which overturned an IRS interpretation that disallowed these individuals.

The payments will be based on the most recently filed income tax return. Taxpayers may be advised to delay filing the 2020 tax return if 2019 AGI is lower than the more recent year and phase-out thresholds would be operative. But this must be balanced by how many qualifying dependents are reported on each return.

If the full payment is not received, any balance may be claimed as a credit on the 2021 tax return. For instance, this will occur if a child is born in 2021. Conversely, any excess payment will not have to be repaid.

Unemployment Benefits

The ARPA extends the federal unemployment insurance assistance originally put in place under the CARES Act through September 6, 2021. It increases the total number of weeks of benefits available to individuals who cannot return to work safely from 50 to 79 and continues the federal supplement at the current level of $300 a week beginning March 14 and ending September 6, 2021.

The Senate adopted an amendment to the original House version of the ARPA providing that the first $10,200 of an individual's unemployment income received in 2020 would be exempt from income tax. If married filing jointly, each spouse is allowed the $10,200 exemption for their individual unemployment compensation. The exemption does not apply if AGI exceeds $150,000.

It should be noted that the AGI limit is a cliff without any phase-out range and applies regardless of filing status. Similarly, any exemption amount in excess of actual unemployment compensation received by one spouse cannot be utilized by the other spouse. Taxpayers who have already filed their 2020 income tax returns do not need to file an amended return to claim this benefit. The IRS will refigure the tax liability of a taxpayer under this new provision and will issue additional refunds where appropriate.

Child Tax Credit

The child tax credit for 2021 has been significantly modified to increase and accelerate payments to families with dependent children. To understand the changes, it is helpful to first understand the pre-ARPA credit structure. In 2020, a maximum credit of $2,000 (up to $1,400 of which could be refundable) applied for each dependent child who was 16 or younger at the end of the year. A $500 credit was available for dependents who did not qualify for the child tax credit. Phase-out of the credit began at $200,000 of AGI for single taxpayers ($400,000 for married filing jointly).

For 2021, the credit amount has been increased to $3,600 for any child under six at the end of the year and $3,000 for children from six to 17 years old (an increase from the 16 years-old age limit in prior years). The refundable portion of the credit will increase to $1,500 or $1,800 per child depending on age.

The increased credit is only available for single taxpayers with AGI of less than $75,000 (married filing jointly with AGI of less than $150,000 or head of household of less than $112,500). Those earning more than these limits can still claim the existing $2,000 credit up to the previous phase-out limits. In addition, the prior requirement that the credit could only be claimed by those earning at least $2,500 per year has been eliminated.

Previously, the credit was claimed in total by filing the annual income tax return. This has been modified by allowing taxpayers to elect to receive half of the credit in equal monthly payments spread over

Table 1

Max Earnings, Single/ Head of Household	Max Earnings, Married Jointly	Number of Children	Max EITC
$15,980	$21,920	0	$543
$32,158	$48,108	1	$3,618
$47,915	$53,865	2	$5,980
$51,464	$57,414	3 or more	$6,728

the second half of 2021. The advance payment amount will have to be reconciled with the actual credit determined on the 2021 tax return. The reconciliation includes a safe harbor for taxpayers earning less than an AGI limit.

The thresholds for phase-out range of AGI are between $40,000 to $80,000 for single taxpayers, $60,000 to $120,000 for married filing jointly and $50,000 to $100,000 for heads of household. Qualifying taxpayers can exempt overpayments of up to $2,000 per child.

It should be noted that although the enhanced child tax credit is only effective for 2021, there is discussion within Congress of extending this provision indefinitely.

Child and Dependent Care Credit

In addition to changes in the child tax credit, modifications were made to the credit for the costs of third-party child and dependent care. These changes are effective for 2021 only.

The credit was increased to 50% of up to $8,000 of childcare costs for a child under 13 and up to $16,000 of childcare costs for two or more children. This is a significant increase in both the percentage and the ceiling on allowable costs. The credit can also apply to a spouse or other dependent without age limitations if the individual is physically or mentally incapable of caring for themselves.

To qualify for the credit, the taxpayer must have earned income of at least $2,500. In addition, the amount of qualified expenses begins to be reduced with AGI of $200,000 for single taxpayers and $400,000 for married filing jointly.

The ARPA also makes the 2021 credit refundable, another change from prior years.

Although not part of the credit, the ARPA increases the amount of employer-provided dependent care assistance that can be excluded from an employee's gross income to $10,500 from $5,000 ($5,250 for married filing separately from $2,500).

Earned Income Tax Credit (EITC)

For 2021, the EITC ranges from $543 to $6,728 (increased from $538 to $6,660) dependent on filing status, number of children and level of earned income. Table 1 details the interplay between earned income and number of children.

As with the EITC in 2020, taxpayers may calculate their 2021 credit using their 2019 taxable income if it results in a higher credit. The amount of allowable investment income has also been increased from $2,200 to $10,000 before the credit is disallowed.

The qualification for the credit for filers without children has been expanded to include filers 19 or older except for students who must be 24. Qualified former foster or homeless youth qualify if 18 or older. There is no maximum age for the 2021 credit. Previously, taxpayers had to be at least 25 and less than 65 years old.

Also note that the previous law disallowed the EITC to an otherwise eligible individual who could not meet the identification requirements for any qualifying children. Under the ARPA, a qualifying individual who cannot meet the identification requirements for any qualifying children can claim the EITC as a qualifying individual with no children.

Assistance for Health Care

In addition to direct payments and the credits mentioned above, two of the provisions focus on health care. First, the ARPA extends the advance health insurance premium tax credit through 2022. In addition, any excess payment of the 2020 advance premium credit will not have to be repaid. Taxpayers who have received or are approved to receive unemployment in 2021 will be treated as having income no greater than 133% of the federal poverty level, thus providing for the maximum credit.

Further, the ARPA eliminated the cap on credits for taxpayers whose earnings are more than 400% of the federal poverty level. Credits are therefore available to higher income earners purchasing insurance on the public exchanges.

The ARPA also provides for 100% COBRA premium assistance from April 1 to September 30, 2021. The provision does not extend the period of eligibility for COBRA coverage however.

Student Loans

Although the forgiveness of student loans has been a topic of discussion stemming from the election campaigns, the ARPA takes only a small step in that direction. Any discharge of student loan indebtedness after December 31, 2020 and before January 1, 2026 will not result in gross income from forgiveness of debt. The definition of student loans eligible for this exclusion is broad and includes (but is not limited to) those guaranteed by a federal, state or local governmental entity or education institution, and also private education loans (among others).

Employment Credits Extended

The credit for employee retention enacted under the CARES Act has been extended under the ARPA until the end of 2021. The qualifications for the credit have not changed but the reduction in payroll taxes has been expanded to include the Medicare tax.

The ARPA also extends the period for credits for paid sick leave and paid family leave to employers for COVID-19 related absences originally granted in the Families First Coronavirus Response Act. The fully refundable credits offset payroll taxes related to the compensation for the leaves. The limit on the credit for paid family leave has been increased to $12,000.

As part of the extension of the credits, paid time away from work related to vaccination now qualifies. The number of days taken into account for paid sick leave will reset after March 31. In addition, the number of days self-employed individuals can qualify for family leave has been increased from 50 to 60.

Several Miscellaneous Business Provisions Also Included

Likely the most notable miscellaneous provision is the expansion of Section 162(m) of the Code that generally denies a corporate tax deduction for compensation in excess of $1 million paid to top executive officers of publicly traded companies, known as covered employees. Current regulations apply the limitation to the CEO, CFO and the three next highest paid employees. Beginning in 2027, the limitation will be expanded to include the next five highest paid employees after the current list, bringing the total to 10 employees. The ARPA also repealed the worldwide interest expense allocation, which is generally favorable to corporations in the determination of foreign source income for purposes of the foreign tax credit. The repeal is effective for tax years beginning after December 31, 2020.

The limitation on excess business losses for noncorporate taxpayers under Sec. 461(l) was extended for another year to years ending before January 1, 2027. Losses are limited to $250,000 with indexation for inflation.

Finally, the ARPA provided that Economic Injury Disaster Loan grants or restaurant revitalization grants from the Small Business Administration will not be included in gross income of the recipient nor will any deductions be denied for items funded by the grants. When combined with the CARES Act of 2020 and the Consolidated Appropriations Act of 2021, the American Rescue Plan continues the trend of providing economic relief to a broad section of the population through both direct payments and modification to tax credits.

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