Chapter 1: New Developments

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Please note. Corrections were made to this workbook through January of 2022. No subsequent modifications were made.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

About the Author

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This chapter begins with a description of the IRS Tax Pro Account online portal for tax practitioners. The remainder of the chapter concentrates on how the most recent legislation impacts previously enacted laws and creates new provisions.

In late 2020 and early 2021, Congress passed two major acts. The impact of these acts on existing laws and the passage of new laws create significant challenges and opportunities for tax professionals and their clients. For the reader's convenience in locating these issues, there are acronyms in the left margins highlighting areas of impact and their source.

CAA **Consolidated Appropriations Act of 2021 (CAA).**[1] On December 27, 2020, President Trump signed into law the CAA. The CAA is an omnibus spending package that contains many tax-related provisions intended to alleviate the economic effects associated with the COVID-19 pandemic. Many of the tax relief provisions contained in the CAA are found in title II of division N of the CAA. Additional tax provisions are found in division EE of the CAA, including extensions of expiring provisions and provisions related to disaster relief.

ARPA **American Rescue Plan Act (ARPA).**[2] On March 11, 2021, President Biden signed into law the ARPA. The ARPA provides additional relief to address the effects of COVID-19 on the economy, public health, state and local governments, individuals, and businesses.[3]

Additional legislation flagged similarly include the following.

CARES **The Coronavirus Aid, Relief, and Economic Security Act (CARES).**[4] The CARES Act responded to the COVID-19 outbreak and its impact on the economy, public health, state and local governments, individuals, and businesses. It provided cash flow assistance to small businesses through federally guaranteed loans, provided emergency economic relief for small businesses to meet their payroll and expenses, required the Department of Labor to provide pandemic unemployment assistance to certain workers, and provided access to healthcare for COVID-19 patients.

FCAA **Further Consolidated Appropriations Act of 2020 (FCAA).**[5] The FCAA contained provisions to enhance retirement security, which were codified as the Setting Every Community Up for Retirement Enhancement (SECURE) Act. It contained other provisions to repeal certain Affordable Care Act taxes, provide disaster tax relief, and extend certain expired or expiring tax provisions.

FFCRA **Families First Coronavirus Response Act (FFCRA).**[6] The FFCRA responded to the COVID-19 pandemic by providing paid sick leave, free COVID-19 testing, expanded food assistance and unemployment benefits and increased Medicaid funding. It gave eligible employers funds to provide employees with paid sick and family and medical leave in connection with COVID-19.

TCJA **Tax Cuts and Jobs Act (TCJA).**[7] The TCJA decreased individual income tax rates and temporarily repealed many individual deductions and credits, while increasing others. Personal exemptions were repealed temporarily, which the standard deduction was increased. Most of the changes end December 31, 2025.

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1. *Consolidated Appropriations Act of 2021,* PL 116-260.
2. *American Rescue Plan Act,* PL 117-2.
3. *HR 1319 — American Rescue Plan Act of 2021.* Mar. 11, 2021. Congress.gov. [www.congress.gov/bill/117th-congress/house-bill/1319/summary/00] Accessed on May 24, 2021.
4. *CARES Act,* PL 116-136.
5. *Further Consolidated Appropriations Act of 2020,* PL 116-94.
6. *Families First Coronavirus Response Act*, PL 116-127.
7. *Tax Cuts and Jobs Act,* PL 115-97.

IRS ESTABLISHES TAX PRO ACCOUNTS[8]

The IRS Tax Pro Account is an online portal for tax practitioners. The portal allows for virtual creation of powers of attorney (POA) and permits access to individual taxpayer information **once a taxpayer has created their own IRS online account** and grants authorization to their tax professional. The taxpayer must digitally sign for approval of the request.

Advantages of integrating between the taxpayer IRS Online Account and the Tax Pro Account include the following.

- Taxpayers may use the IRS Online Account to authorize their tax preparer to represent them by submitting a POA and view their tax accounts with a Tax Information Authorization (TIA).
- Tax professionals may use their Tax Pro Account to initiate POAs and TIAs digitally.
- The completed digital authorization will immediately be recorded and appear in the Centralized Authorization File (CAF) database without manual processing by the IRS.

Authorizations for POA and TIA may be requested for tax years 2000 through the current year, plus three future years. For 2021, authorizations may be requested for 2000-2024.

The IRS is planning to release additional features, including managing authorization records proactively, viewing or canceling pending requests, and viewing or printing submission confirmations.

The IRS has released the following resources:

- Publication 5533, *Why You Should Create an IRS Online Account*
- Publication 5533-A, *How to Submit Authorizations Using Tax Pro Account and Online Account*
- Publication 5533-B, *Benefits of Tax Pro Account and Digital Authorizations*

Practitioner Planning Tip

With access to client information continuing to move toward digital delivery methods (and away from other methods such as phone calls to IRS), practitioners should encourage taxpayers to establish online access to their information and suggest taxpayers create meaningful passwords to prevent cyber theft. As explained previously, **online** action is required on the taxpayer's part to grant permission to the tax professional for access to their records. Taxpayers may be directed to the IRS website entitled *View Your Account Information* at **uofi.tax/21a1x1** [www.irs.gov/payments/view-your-tax-account] to click on '*Create or view your account*' for more information or to establish their online IRS account portal.

8. IRS News Rel. 2021-154 (Jul. 19, 2021); *IRS improves services to taxpayers with digital authorizations and launch of new Tax Pro Account.* Jul. 19, 2021. IRS. [www.irs.gov/newsroom/irs-improves-services-to-taxpayers-with-digital-authorizations-and-launch-of-new-tax-pro-account] Accessed on Aug. 1, 2021.

TAX TREATMENT OF FORGIVENESS OF PPP LOANS

CARES

OLD LAW

The CARES Act established the Paycheck Protection Program (PPP).[9] Small businesses that laid off workers or reduced their workforce due to COVID-19 issues were the program's intended beneficiaries. The PPP was designed to provide short-term payroll assistance for businesses affected by COVID-19 to either retain workers or bring employees back to work during the pandemic.

Once an eligible small business or independent contractor received a PPP loan, it could be used for the following qualified purposes.[10]

- Payroll costs
- Costs for continuing group healthcare benefits during periods of paid sick, medical, or family leave, and insurance premiums
- Payments of interest on any business mortgages (but not prepayment fees or principal payments on the mortgage)
- Rent (including rent under a lease agreement)
- Utilities
- Interest on any other debt obligations that existed before the covered period, which was initially defined as the period beginning on February 15, 2020, and ending on June 30, 2020. The Paycheck Protection Program Flexibility Act of 2020 (PPPFA) extended the covered period to 24 weeks or December 31, 2020, whichever is earlier.[11]

One of the PPP's most noteworthy features is that the borrower can have the loan forgiven.[12] To have PPP loans forgiven, the borrower must **meet three requirements.**[13]

1. The loan was used exclusively for authorized purposes.
2. The loan was used to offset no more than eight weeks (24 weeks under the PPPFA) of eligible expenses.
3. The business retained employees or payroll at salary levels comparable to before the COVID-19 pandemic.

If any of the PPP proceeds were not used for the purposes described previously, the amount used for unauthorized purposes must be repaid.[14]

As mentioned previously, PPP loan proceeds used to fund qualifying expenses may be forgiven. In addition, any forgiven amounts are **excluded from the gross income of the loan recipient.** The CARES Act did not explicitly address whether the borrower could also deduct the eligible expenses paid using PPP loan proceeds that are then forgiven.

9. *CARES Act,* PL 116-136, §§2102 and 2104(b).
10. *CARES Act,* PL 116-136, §1102(a), amending §7(a) of the Small Business Act (15 USC §636(a)).
11. *Paycheck Protection Program Flexibility Act of 2020,* PL 116-142, §3(a).
12. *CARES Act,* PL 116-136, §1106.
13. *CARES Act,* PL 116-136, §1106(b).
14. 85 Fed. Reg. 20811, 20814 (Apr. 15, 2020).

The IRS issued Notice 2020-32[15] to address the effect of covered loan forgiveness on the deductibility of corresponding business expenses. Specifically, the IRS provided that income resulting from PPP loan forgiveness should be classified as "exempt income" under IRC §265. IRS Notice 2020-32 clarified that otherwise deductible business expenses are disallowed to the extent of the resulting covered loan forgiveness because such payment is allocable to tax-exempt income.

> **Note.** For more information about PPP loans, see the 2021 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 6: Small Business Issues.

CAA

NEW LAW[16]

Reversing the IRS's position in Notice 2020-32, the CAA provides that **no deduction of business expenses will be disallowed** because the forgiven PPP loan amount was excluded from the recipient's gross income. In addition, **no tax attribute should be reduced and no basis increase should be denied** because of such loan forgiveness, as is required under IRC §108 for certain other forgiven debts.

Amounts forgiven under the PPP for partnerships and S corporations are treated as tax-exempt income when determining a partner's basis under IRC §705 or the pass through of items to an S corporation shareholder under IRC §1366. Any increase in the partner's interest in the partnership under §705 related to the forgiven loan amount is equal to the partner's distributive share of deductions resulting from expenses that gave rise to the forgiveness.

These provisions apply retroactively to tax years ending after March 27, 2020 (date of the enactment of the CARES Act). These provisions also apply to tax years ending after December 27, 2020 (date of enactment of the CAA).

> **Note.** In August of 2021, the Small Business Association (SBA) announced the opening of a portal for PPP borrowers of less than $150,000 to apply directly with SBA for PPP forgiveness, rather than going through their lender.[17] Visit **uofi.tax/21a1x2** [directforgiveness.sba.gov/requests/borrower/login] for more information.

MODIFICATION AND EXTENSION OF ERC

CARES

OLD LAW[18]

The CARES Act provided an employee retention credit (ERC), which is a refundable tax credit available to employers that is equal to 50% of qualified wages that eligible employers pay to their employees. The ERC applies to qualified wages (including allocable qualified health plan expenses) paid after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages that can be taken into account for each employee for **all** calendar quarters is $10,000. Therefore, the maximum credit for qualified wages paid to any employee is $5,000.

> **Note.** Under the provisions of the CARES Act, an eligible employer could not receive the ERC if it received a PPP loan authorized under the CARES Act.

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15. IRS Notice 2020-32, 2020-21 IRB 837.

16. *Consolidated Appropriations Act of 2021,* PL 116-260, §276, Div. N.

17. *SBA Announces Opening of Paycheck Protection Program Direct Forgiveness Portal.* Jul. 28, 2021. SBA. [www.sba.gov/article/2021/jul/28/sba-announces-opening-paycheck-protection-program-direct-forgiveness-portal] Accessed on Jul. 30, 2021.

18. *CARES Act,* PL 116-136, §2301; *COVID-19-Related Employee Retention Credits: General Information FAQs.* Mar. 1, 2021. IRS. [www.irs.gov/newsroom/covid-19-related-employee-retention-credits-general-information-faqs] Accessed on Mar. 4, 2021.

Eligible Employer

An eligible employer for purposes of the ERC is an employer that carries on a trade or business during 2020, including a tax-exempt organization, which meets one of the following conditions.

- Fully or partially suspends operations during any calendar quarter in 2020 because of orders from a governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19
- Experiences a significant decline in gross receipts during the calendar quarter

Note. Governmental employers are not eligible employers for the ERC under the CARES Act. In addition, self-employed individuals are not eligible for the credit for their own self-employment (SE) earnings or services under the CARES Act. However, a self-employed person may be eligible for the ERC with respect to qualified wages the self-employed person pays to employees.[19]

Partially Suspended Operations. A trade or business is considered to partially suspend (e.g., operating hours or capacity was limited) operations if any appropriate governmental authority (e.g., federal, state, or local law) imposes restrictions upon the business operations by limiting commerce, travel, or group meetings due to COVID-19 to such a degree that the operation can still operate but not at its normal capacity.

Note. Wages are only qualified for the time period the trade or business is suspended, not for the entire quarter.[20]

Significant Decline in Gross Receipts. A significant decline in gross receipts occurs beginning with the first quarter in which an employer's gross receipts for a calendar quarter in 2020 are less than 50% of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts **ends** with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80% of its gross receipts for the same calendar quarter during 2019.

Example 1. Nirvana Company's gross receipts for 2019 and 2020 are shown in the following table.

	2019 Gross Receipts	2020 Gross Receipts	2020 Gross Receipts as a Percentage of 2019 Gross Receipts	Qualified for ERC?
First quarter	$210,000	$100,000	47.6%	Yes
Second quarter	200,000	95,000	47.5%	Yes
Third quarter	230,000	190,000	82.6%	Yes
Fourth quarter	250,000	230,000	92.0%	No

For the first and second quarters of 2020, Nirvana Company's gross receipts were less than 50% of the same quarters in 2019. Therefore, the company qualified as having a significant decline in gross receipts for those quarters. Despite having third quarter receipts above 80% of the 2019 level, CCA treats the company as still suffering from the significant declines of revenue during the third quarter. The decline is not treated as **ending** until the quarter **following** the quarter the company's receipts were above 80% of the comparison period. Accordingly, Nirvana Company is an eligible employer for purposes of the ERC for the first, second, and third quarters of 2020, but not the fourth quarter.

Observation. Even if second quarter gross receipts for Nirvana Company were at 60%, the result would be the same.

19. IRS Notice 2021-20, 2021-11 IRB 922.

20. *COVID-19-Related Employee Retention Credits: Determining Qualified Wages FAQs*. Apr. 26, 2021. IRS. [www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-qualified-wages-faqs] Accessed on Jul. 30, 2021.

Safe Harbor Provision. On August 10, 2021, the IRS released Rev. Proc. 2021-33.[21] It contains **a safe harbor provision for determining gross receipts** in the calculations required for the ERC. Taxpayers utilizing the safe harbor may **exclude** the following from gross receipts.

- The amount of PPP forgiven loans
- Shuttered Venue Operators Grants under the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act; and
- Restaurant Revitalization Grants under the ARPA

The Rev. Proc. explains that an employer elects to apply the safe harbor by excluding amounts from the listed programs mentioned to determine if they are an eligible employer for a calendar quarter for the ERC.

Employers must apply the safe harbor consistently for determining ERC eligibility by excluding amounts from the listed programs mentioned from their gross receipts for each calendar quarter in which gross receipts are used to determine ERC eligibility. The employer claiming the credit must also apply the safe harbor to all employers treated as a single employer under the aggregation rules.

An employer is not required to use the safe harbor, and the Rev. Proc. explains the safe harbor does not permit the exclusion from gross receipts amounts from the programs mentioned for any other federal tax purpose.

The Rev. Proc. is intended to update and provide clarification for IRS Notice 2021-20[22] regarding ERC calculations for qualified wages paid after March 12, 2020, and before January 1, 2021; IRS Notice 2021-23[23] addressing ERC calculations for qualified wages paid after December 31, 2020 and before July 1, 2021, and IRS Notice 2021-49,[24] which addresses ERC calculations for qualified wages paid after June 30, 2021 and before January 1, 2022.

Qualified Wages

Qualified wages are wages (as defined in IRC §3121(a)) and compensation (as defined in IRC §3231(e)) paid by an eligible employer to employees after March 12, 2020, and before January 1, 2021. Qualified wages include qualified health plan expenses that are properly allocable to the wages. The definition of qualified wages depends on the average number of full-time employees employed by the eligible employer in 2019.

For employers that averaged **more than 100 full-time employees in 2019,** qualified wages are the wages paid to an employee for time that the employee is **not providing services** for either of the following reasons.

1. A full or partial suspension of operations by a governmental order due to COVID-19
2. A significant decline in gross receipts

For employers with more than 100 full-time employees in 2019, the amount of an employee's qualified wages taken into account may not exceed what the employee would have been paid for working an equivalent period during the 30 days immediately preceding the period of economic hardship.

For employers that averaged **100 or fewer full-time employees in 2019,** qualified wages are the wages paid to any employee during any period of economic hardship described in items 1 or 2 above.

Qualified health plan expenses that are properly allocable to qualified wages are amounts paid or incurred by the employer to provide and maintain a group health plan, to the extent such amounts are excluded from the employees' income as coverage under an accident or health plan.[25]

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21. Rev. Proc. 2021-33, 2021-34 IRB 327.
22. IRS Notice 2021-20, 2021-11 IRB 922.
23. IRS Notice 2021-23, 2021-16 IRB 1113.
24. IRS Notice 2021-49, 2021-34 IRB 316.
25. *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Mar. 4, 2021.

Calculating the 2020 Credit

As mentioned earlier, the 2020 ERC is 50% of the qualified wages (including qualified health plan expenses) that an eligible employer pays in a calendar quarter. The maximum amount of qualified wages taken into account for each employee for all calendar quarters is $10,000. Therefore, the maximum allowable credit for qualified wages paid to any employee is $5,000.

Example 2. Use the same facts as **Example 1.** Nirvana Company paid Lucinda $8,000 in qualified wages in the second quarter of 2020 and $8,000 in qualified wages in the third quarter of 2020. The ERC available to Nirvana Company for the qualified wages paid to Lucinda is $4,000 ($8,000 wages × 50%) in the second quarter and $1,000 (($10,000 maximum wages – $8,000 second quarter qualified wages) × 50%) in the third quarter.

Claiming the Credit

Eligible employers report their total qualified wages and the related credits for each calendar quarter on their federal employment tax returns (e.g., Form 941, *Employer's Quarterly Federal Tax Return)*. In anticipation of receiving the ERC, eligible employers can fund the payment of qualified wages by accessing federal employment taxes otherwise required to be deposited with the IRS or by requesting an advance of the credit. Consequently, an eligible employer that pays qualified wages to its employees before it is required to deposit federal employment taxes with the IRS for that quarter can reduce the amount of federal employment taxes it deposits for that quarter by half the amount of qualified wages paid in that quarter. The employer must account for the reduction in deposits on the federal employment tax return it files for the quarter.

If the employer does not have sufficient federal employment taxes, it is otherwise required to deposit in a sufficient amount to fund their qualified wages, the employer can file a Form 7200, *Advance Payment of Employer Credits Due to COVID-19,* to claim an advance refund. The employer should first reduce its remaining federal employment tax deposits for wages paid in the same calendar quarter by the amount of the anticipated ERC. The employer can then file the Form 7200 to claim an advance refund for the full amount of the anticipated credit for which it did not have sufficient federal employment tax deposits.

NEW LAW[26]

The CAA made changes to the ERC that apply to employers who paid qualified wages after March 12, 2020 and before January 1, 2021. The CAA also extended and modified the ERC for qualified wages paid after December 31, 2020, and before July 1, 2021.[27] The ARPA extends and modifies the ERC for qualified wages paid after June 30, 2021, and before January 1, 2022.[28]

CAA

Changes that Apply Before January 1, 2021[29]

IRS Notice 2021-20 provides guidance addressing the ERC as it applies to qualified wages paid after March 12, 2020, and before January 1, 2021.

As mentioned earlier, the CARES Act provided that an eligible employer that received a PPP loan would not be eligible for the ERC. The CAA amended this provision to **permit an employer that received a PPP loan to be eligible to claim an ERC.** This provision is effective retroactively to the effective date of the CARES Act (March 27, 2020).

Under this provision, an employer can claim the ERC even if it received a PPP loan. The eligible employer can claim the ERC on any qualified wages that are not counted as payroll costs when obtaining PPP loan forgiveness. Any wages that are eligible for the ERC or PPP loan forgiveness can be applied to either program, but **not both.**[30]

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26. *Consolidated Appropriations Act of 2021,* PL 116-260, §§206 and 207, Div. EE. See also IRS Notice 2021-20, 2021-11 IRB 922.

27. IRS News Rel. 2021-48 (Mar. 1, 2021).

28. *American Rescue Plan Act,* PL 117-2, §9651.

29. IRS Notice 2021-20, 2021-11 IRB 922.

30. *Employers May Be Able to Claim the Employee Retention Credit and Have a PPP Loan.* Feb. 2, 2021. IRS. [www.irs.gov/forms-pubs/employers-may-be-able-to-claim-the-employee-retention-credit-and-have-a-ppp-loan] Accessed on Mar. 5, 2021.

The CAA amendments permit an eligible employer to elect not to take into account certain qualified wages for purposes of the ERC. An eligible employer makes the election by not claiming the ERC for those qualified wages on its federal employment tax return. However, an eligible employer that received a PPP loan is deemed to have made an election for qualified wages included in the amount reported as payroll costs on a PPP loan forgiveness application. The amount for which the eligible employer is deemed to have made the election is the qualified wages included in the payroll costs reported on the PPP loan forgiveness application up to the minimum amount of payroll costs sufficient to support the PPP loan amount that is forgiven.

The ERC does not apply to the qualified wages for which an election or deemed election is made. If an employer receives forgiveness of only a portion of the PPP loan amount, the employer is deemed to have made an election for the minimum amount of qualified wages included in the payroll costs reported on the PPP loan forgiveness application that were necessary to receive forgiveness of that amount of the PPP loan.[31]

An eligible employer that received a PPP loan and did not claim the ERC can file a Form 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund,* for the relevant calendar quarters in which the employer paid qualified wages for which no deemed election was made. This allows the employer to claim the ERC on qualified wages paid in the past calendar quarter.[32]

Changes that Apply After December 31, 2020[33]

Eligible employers can claim an ERC equal to **70% of qualified wages** (including allocable qualified health plan expenses) they pay to their employees after December 31, 2020, through June 30, 2021. Qualified wages for this period are limited to $10,000 per employee **per calendar quarter** in 2021. Therefore, the maximum ERC available is $7,000 per employee per calendar quarter, for a total of $14,000 for the first two quarters of 2021.

> **Note.** These changes reflect an increase from the 50% rate that applied prior to January 1, 2021, to the 70% rate that applies in 2021. In addition, the maximum amount of qualified wages that can be taken into account for each employee for the full year of 2020 is $10,000, while qualified wages are limited to $10,000 **per quarter** in 2021.

As was the case under the ERC rules that applied prior to January 1, 2021, employers can access the ERC for the first two quarters of 2021 prior to filing their employment tax returns by reducing their employment tax deposits. Small employers (now defined as employers with an average of **500 or fewer** full-time employees in 2019) can request advance payment of the credit using Form 7200 after reducing their deposits.

Effective January 1, 2021, employers are eligible for the ERC if they operate a trade or business during January 1, 2021, through June 30, 2021, and experience one of the following.

1. A full or partial suspension of the operation of their trade or business during this period because of governmental orders limiting commerce, travel, or group meetings because of COVID-19
2. A decline in gross receipts in a 2021 calendar quarter when the gross receipts of that quarter are less than 80% of the gross receipts in the same calendar quarter in 2019 (decline in gross receipts test)

> **Note.** To be eligible based on a decline in gross receipts in 2020, the gross receipts had to be less than 50% of the gross receipts for the same quarter in 2019.

31. IRS Notice 2021-20, 2021-11 IRB 922.
32. Ibid.
33. IRS News Rel. 2021-21 (Jan. 26, 2021); IRS Notice 2021-23, 2021-16 IRB 1113.

The CAA expands the definition of eligible employer to include the following entities.

1. Any tax-exempt organization described in IRC §501(c)(1)
2. Any governmental entity that is a college or university
3. Any governmental entity that has a principal purpose or function of providing medical or hospital care

Such entities may be eligible employers for the period January 1, 2021, through June 30, 2021, if they satisfy the other requirements to be eligible employers.

The CAA also changes the definition of qualified wages effective January 1, 2021, as follows.

- For an employer with an average of **more than 500** full-time employees in 2019, qualified wages are generally wages paid to employees who are **not providing services** because operations were fully or partially suspended or due to the decline in gross receipts.
- For an employer with an average of **500 or fewer** full-time employees in 2019, qualified wages are generally **wages paid to all employees** during a period when operations were fully or partially suspended or during the quarter that the employer had a decline in gross receipts **regardless of whether the employees are providing services.**

> **Note.** The definition of qualified wages differs based on whether the employer had 500 or fewer employees or more than 500 employees in 2021. For 2020, the definition of qualified wages depends on whether the employer had 100 or fewer employees or more than 100 employees.

Prior to January 1, 2021, for employers with more than 100 full-time employees, the amount of an employee's qualified wages taken into account for the ERC could not exceed what the employee would have been paid for working an equivalent period during the 30 days immediately preceding the period of economic hardship. The CAA removes this limitation on qualified wages paid during the first and second quarters of 2021 by large employers (now defined as employers with more than 500 full-time employees).[34]

Alternative Quarter Selection. The CAA allows an employer to elect to use an alternative quarter to calculate gross receipts. **Employers that did not exist in 2019 can use the corresponding quarter in 2020 to measure the decline in gross receipts. Under this election, for the first two quarters of 2021, employers can measure the decline in their gross receipts using the immediately preceding calendar quarter (e.g., the fourth calendar quarter of 2020 and the first calendar quarter of 2021) compared to the same calendar quarter in 2019.**

Accordingly, for the first quarter of 2021, an employer can elect to compare its gross receipts for the fourth calendar quarter of 2020 to those for the fourth calendar quarter of 2019 to determine if it satisfies the decline in gross receipts test. If the employer was not in existence at the beginning of the fourth calendar quarter of 2019, then the alternative quarter election is not available to that employer for the first calendar quarter of 2021.

Example 3. Ramsey Landscaping Services had gross receipts of $500,000 for the first calendar quarter of 2019. For the first quarter of 2021, Ramsey's gross receipts were $450,000, or 90% (fails 80% of gross receipts test) of its gross receipts for the corresponding quarter in 2019. Using this measurement, Ramsey does not satisfy the decline in gross receipts test.

Using the alternative quarter election, Ramsey does satisfy the decline in gross receipts test. Ramsey's gross receipts for the fourth quarter of 2019 were $450,000. Its gross receipts for the fourth quarter of 2020 were $350,000, or 77.8% (less than 80% gross receipts test) of its gross receipts for the corresponding quarter in 2019.

34. *Consolidated Appropriations Act of 2021,* PL 116-260, §206, Div. EE; See also IRS Notice 2021-23, 2021-16 IRB 1113.

ARPA Changes that Apply After June 30, 2021[35]

Under the ARPA, eligible employers can claim an ERC equal to **70% of qualified wages** (including allocable qualified health plan expenses) they pay to their employees. Qualified wages for this period are limited to $10,000 per employee **per calendar quarter**. These are the same limits that applied under the CAA for the first two calendar quarters of 2021. However, any eligible employer that is a **recovery startup business** (defined later) is limited to an ERC of $50,000 for any calendar quarter, after applying the qualified wages limit of $10,000 per employee per calendar quarter.

> **Note.** IRS Notice 2021-49[36] clarified that eligible recovery startup businesses with qualified wages also may receive ERC for the third and fourth quarters of 2021.[37]

Eligible Employer. An **eligible employer** for purposes of the ERC is an employer that carries on a trade or business during the quarter for which the credit is determined, including a tax-exempt organization, that meets **one** of the following conditions.

1. Fully or partially suspends operations during the calendar quarter because of orders from a governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19
2. Has gross receipts during the calendar quarter that are less than 80% of the employer's gross receipts for the same calendar quarter in 2019 (Employers that were not in existence during the applicable calendar quarter in 2019 should use the same calendar quarter in 2020.)
3. Is a recovery startup business

A **recovery startup business** is defined as any employer:[38]

- That began carrying on a trade or business after February 15, 2020;
- For which the average annual gross receipts for the three tax years ending with the tax year that precedes the calendar quarter for which the credit is determined does not exceed $1 million; and
- Did **not** have its operations fully or partially suspended during the calendar quarter because of orders from a governmental authority and did **not** have gross receipts during the calendar quarter that are less than 80% of the employer's gross receipts for the same calendar quarter in 2019.

Qualified Wages. The definition of qualified wages varies, depending on the size of the employer.

- For an employer with an average of **more than 500** full-time employees in 2019, qualified wages are generally wages paid to employees who are **not providing services** because operations were fully or partially suspended or due to a decline in gross receipts of more than 20% compared to the same calendar quarter in 2019.
- For an employer with an average of **500 or fewer** full-time employees in 2019, qualified wages are generally **wages paid to all employees** during a period when operations were fully or partially suspended or during the quarter that the employer had a decline in gross receipts of more than 20% **regardless of whether the employees are providing services.**
- For **severely financially distressed employers,** qualified wages are wages paid by such employer to an employee during the calendar quarter. This applies regardless of the number of full-time employees the employer had in 2019. A severely financially distressed employer is one that has gross receipts during the calendar quarter that are **less than 10%** of the employer's gross receipts for the same calendar quarter in 2019.

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35. *American Rescue Plan Act,* PL 117-2, §9651.
36. IRS Notice 2021-49, 2021-34 IRB .
37. IRC §3134(c)(2)(A)(ii)(iii).
38. IRC §3134(c)(5).

Employers that were not in existence in 2019 determine qualified wages based on the average number of full-time employees the employer had in 2020 (rather than in 2019). In addition, an employer can elect to use an alternative quarter to calculate gross receipts. Under this election, employers can measure the decline in their gross receipts using the immediately preceding calendar quarter compared to the corresponding calendar quarter in 2019.

The employer can elect not to take certain qualified wages into account for purposes of the credit.

Coordination with Certain Programs. The ERC cannot be taken for qualified wages paid by an eligible employer that are taken into account as payroll costs in connection with one of the following programs.

- A covered PPP loan under §§7(a)(37) or 7A of the Small Business Act
- A Shuttered Venue Operators Grant under §324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act
- A restaurant revitalization grant under §5003 of the ARPA

The eligible employer can claim the ERC on any qualified wages that are not counted as payroll costs when obtaining PPP loan forgiveness. The ARPA mandates that the Treasury Secretary must issue guidance providing that payroll costs paid during the covered period will not fail to be treated as qualified wages for purposes of the ERC to the extent that:

- The taxpayer's covered PPP loan under §7(a)(37) of the Small Business Act is not forgiven, or
- The taxpayer's covered PPP loan under §7A of the Small Business Act is not forgiven.

> **Note.** For an in-depth discussion and examples of the coordination and maximization of various COVID-19 relief provisions for small businesses, see the 2021 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 6: Small Business Issues.

Advance Payments to Small Employers. Eligible employers report their total qualified wages and the related credits for each calendar quarter on their federal employment tax returns (e.g., Form 941). Under the ARPA, employers with an average of 500 or fewer full-time employees in 2019 can elect an advance payment of the ERC in an amount that does not exceed **70% of the average quarterly wages paid by the employer in the 2019 calendar year.** Employers who employ seasonal workers can calculate the advance payment of the ERC using 70% of the wages for the calendar quarter in 2019 that corresponds to the calendar quarter to which the election relates.

Extension of Limitation on Assessment. The normal statute of limitations for assessing any tax is three years after the return was filed.[39] However, the limitation on the period for the assessment of an amount attributable to the ERC expires on the date that is **five years** after the later of the following.

- The date on which the original return was filed that includes the calendar quarter for which the credit is determined
- April 15 of the succeeding year, which is the date on which the return is treated as filed[40]

39. IRC §6501(a).

40. See IRC §6501(b)(2).

CREDITS FOR PAID SICK AND FAMILY LEAVE

FFCRA
CAA

OLD LAW[41]

On March 18, 2020, President Trump signed into law the FFCRA. The FFCRA gives eligible employers (defined as businesses with fewer than 500 employees) funds to provide employees with paid sick and family leave in connection with COVID-19.

Workers can receive up to 10 days (80 hours) of paid sick leave either for their own health needs or to care for the employee's family members. Employees can also receive up to 10 weeks of paid family leave to care for a child whose school or place of care or childcare provider is closed or unavailable because of COVID-19 precautions. The FFCRA provides **refundable tax credits** to the business to cover the costs of this paid leave. Certain self-employed individuals are also entitled to similar credits.

The credits for qualified leave wages apply to wages paid for the period beginning on **April 1, 2020, and ending on December 31, 2020.** Wage payments made after the end of this period may be eligible for the credits if the wages are for leave taken between those dates.[42]

Payroll Credit for Required Paid Sick Leave[43]

The FFCRA requires eligible employers to provide employees with paid sick leave if the employee is unable to work for any of the following reasons.

1. The employee is under a federal, state, or local quarantine or isolation order related to COVID-19.
2. The employee has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
3. The employee experiences symptoms of COVID-19 and seeks a medical diagnosis.
4. The employee cares for an individual who is subject to a federal, state, or local quarantine or isolation order related to COVID-19 or has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
5. The employee cares for their child if the child's school or place of care has been closed, or the childcare provider is unavailable due to COVID-19 precautions.
6. The employee experiences any other substantially similar condition specified by the U.S. Department of Health and Human Services (HHS).

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41. *Families First Coronavirus Response Act*, PL 116-127, §§7001 and 7003; *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Jan. 28, 2021. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Mar. 2, 2021; *Technical Explanation of Division G, "Tax Credits for Paid Sick and Paid Family and Medical Leave," of H.R. 6201, the "Families First Coronavirus Response Act"* (JCX-10-20). Mar 17, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=fileinfo&id=5251] Accessed on Mar. 2, 2021.

42. See IRS Notice 2020-21, 2020-16 IRB 660.

43. *Families First Coronavirus Response Act*, PL 116-127, §7001; *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Jan. 28, 2021. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Mar. 1, 2021; *Technical Explanation of Division G, "Tax Credits for Paid Sick and Paid Family and Medical Leave," of H.R. 6201, the "Families First Coronavirus Response Act"* (JCX-10-20). Mar 17, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=fileinfo&id=5251] Accessed on Mar. 1, 2021.

An employee who cannot work due to a circumstance described in items 1–3 above is entitled to paid sick leave for up to two weeks (up to 80 hours) at the employee's regular pay rate, or, if higher, the federal minimum wage or any applicable state or local minimum wage. The maximum allowable amount is $511 per day, or a total of $5,110. A part-time worker is eligible for leave equal to the average number of hours the employee works for a 2-week period.[44]

An employee who cannot work due to a circumstance described in items 4–6 above is entitled to paid sick leave for up to two weeks (up to 80 hours) at two-thirds of the employee's regular pay rate or, if higher, the federal minimum wage or any applicable state or local minimum wage. The maximum allowable amount is $200 per day, or a total of $2,000.

The eligible employer is entitled to a refundable tax credit equal to 100% of the amount of the required paid sick leave. The amount of the credit also includes the employer's share of Medicare tax imposed on those wages. The employer is not subject to the employer portion of social security tax on those wages. However, qualified leave wages are subject to withholding of federal income tax and the employee's share of social security and Medicare taxes.

In addition, the allowed credit is increased by the amount of qualified health plan expenses that are properly allocable to the sick leave wages for which the credit is allowed.

Employers claim the credits on their federal employment tax returns (e.g., Form 941). However, employers could recover the money more quickly by reducing their federal employment tax deposits. If the federal employment taxes are insufficient to cover the amount of the credits, the employer could request an advance payment of the credits from the IRS by submitting Form 7200.

Payroll Credit for Required Paid Family Leave[45]

An employee who is unable to work may be entitled to qualified family leave wages. **Qualified family leave wages** are wages that eligible employers must pay eligible employees for periods of leave during which they are unable to work (or telework) due to a need for leave to care for a child if the child's school or place of care has been closed, or because the childcare provider is unavailable due to COVID-19. The first 10 days for which an employee takes leave for this reason may be unpaid; however, an employee may be entitled to receive qualified sick leave wages during that 10-day period. In addition, the employee may be entitled to receive other forms of paid leave under the eligible employer's policy.

The paid family leave is in addition to the paid sick leave credit. The amount of the family leave is two-thirds of the employee's regular pay, up to a maximum of $200 per day, and an aggregate of $10,000. An employee is entitled to up to 10 weeks (or 50 days) of qualifying leave for purposes of the family leave credit.

An eligible employer is entitled to a refundable tax credit equal to the required paid family and medical leave (qualified family leave wages) paid to its employees. The amount of the credit also includes the eligible employer's share of Medicare tax imposed on those wages and the cost of maintaining health insurance coverage for the employee during the leave period. The employer is not subject to the employer portion of social security tax imposed on the leave wages.

Employers claim the credits on their federal employment tax returns (e.g., Form 941). However, they could recover the money more quickly by reducing their federal employment tax deposits. If the federal employment taxes are insufficient to cover the amount of the credits, the employer could request an advance payment of the credits from the IRS by submitting Form 7200.

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44. *Families First Coronavirus Response Act: Employer Paid Leave Requirements.* U.S. Department of Labor. [www.dol.gov/agencies/whd/pandemic/ffcra-employer-paid-leave] Accessed on Mar. 1, 2021.

45. *Families First Coronavirus Response Act,* PL 116-127, §7003; *Tax Credits for Paid Leave Under the Families First Coronavirus Response Act for Leave Prior to April 1, 2021.* Jun. 14, 2021. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Jun. 22, 2021.

Credits for Sick and Family Leave for Self-Employed Individuals[46]

The FFCRA provides comparable sick and family leave credits for eligible self-employed individuals. An **eligible self-employed individual i**s defined as an individual who regularly carries on any trade or business and would be entitled to receive qualified sick or family leave during the tax year under the FFCRA if the individual were an employee of an employer that is subject to the requirements of the FFCRA.

The FFCRA provides eligible self-employed individuals with a tax credit for paid sick leave if the self-employed individual is unable to work or telework for any of the following reasons.

1. The self-employed individual is under a federal, state, or local quarantine or isolation order related to COVID-19.
2. The self-employed individual has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
3. The self-employed individual experiences symptoms of COVID-19 and seeks a medical diagnosis.
4. The self-employed individual cares for an individual who is subject to a federal, state, or local quarantine or isolation order related to COVID-19 or has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
5. The self-employed individual cares for their child if the child's school or place of care has been closed, or the childcare provider is unavailable due to COVID-19 precautions.
6. The self-employed individual experiences any other substantially similar condition specified by the secretary of HHS.

If an eligible self-employed individual is unable to work or telework because of a circumstance described in items 1–3 above, the qualified sick leave equivalent amount is equal to the number of days (up to a maximum of 10 days) during the tax year that the individual cannot perform services in the applicable trade or business for one of those three reasons, multiplied by the lesser of the following.

- $511
- 100% of the individual's average daily SE income for the tax year

If an eligible self-employed individual is unable to work or telework because of a circumstance described in items 4–6 above, the qualified sick leave equivalent amount is equal to the number of days (up to a maximum of 10 days) during the tax year that the individual cannot perform services in the trade or business for one of those three reasons, multiplied by the lesser of the following.

- $200
- 67% of the individual's average daily SE income for the tax year

The qualified **family leave equivalent amount** for an eligible self-employed individual is an amount equal to the number of days (up to 50) during the tax year that the self-employed individual cannot perform services for which they would be entitled to paid family leave if the individual were employed by an eligible employer (described earlier), multiplied by the lesser of the following.

- $200
- 67% of the average daily SE income of the individual for the tax year

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46. *Families First Coronavirus Response Act*, PL 116-127, §§7002 and 7004; *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Jun. 14, 2021. IRS. [www.irs.gov/newsroom/tax-credits-for-paid-leave-under-the-families-first-coronavirus-response-act-for-leave-prior-to-april-1-2021] Accessed on Jun. 22, 2021; *Technical Explanation of Division G, "Tax Credits for Paid Sick and Paid Family and Medical Leave," of H.R. 6201, the "Families First Coronavirus Response Act"* (JCX-10-20). Mar. 17, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=fileinfo&id=5251] Accessed on Jun. 22, 2021.

Average daily SE income for both credits is defined as the individual's net earnings from self-employment for the tax year divided by 260.

The refundable credits are claimed on the self-employed individual's Form 1040, *U.S. Individual Income Tax Return,* for the 2020 tax year.

The self-employed individual can fund the qualified sick and family leave equivalent amount by taking into account the credit to which the individual is entitled in determining required estimated tax payments. Consequently, a self-employed individual can reduce payments of estimated income taxes that they would otherwise be required to make if the individual were not entitled to the credit on their Form 1040.

> **Note.** For information about provisions related to self-employed individuals, see **uofi.tax/21a1x3** [www.irs.gov/newsroom/special-issues-for-employees#specific-provisions-related-self-employed-individuals].

> **Note.** For a thorough explanation of the paid sick and family leave credits, as implemented by the FFCRA, see the 2020 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 1: New Developments.

CAA

CAA Extension and Modification[47]

The CAA extends the tax credits available for eligible employers (generally, employers with fewer than 500 employees) for paid sick and family leave through March 31, 2021. Therefore, an employer is entitled to refundable tax credits for required paid sick leave and required paid family leave wages for the period **beginning April 1, 2020, and ending on March 31, 2021.** The payment of the qualified leaves wages can be made after March 31, 2021, as long as the wages are for leave that an employee took between April 1, 2020, and March 31, 2021.[48]

> **Note.** The federal government, the governments of any state or political subdivision, and any agencies or instrumentalities of those governments are not eligible employers. Consequently, they are not entitled to receive tax credits for providing paid leave wages under the FFCRA. Tribal governments that provide paid sick and paid family and medical leave under the FFCRA are eligible to claim the tax credits for qualified leave wages if they otherwise meet the requirements for eligible employers. In addition, the Department of Labor provides rules that a business with fewer than 50 employees may use to claim an exemption from providing paid sick leave and expanded family and medical leave for the purpose of caring for a child whose school or place of care is closed or whose childcare provider is unavailable for reasons related to COVID-19 if providing these qualified leave wages would jeopardize the viability of their businesses as a going concern. For information about exemptions from the requirement to provide paid sick leave and expanded family and medical leave, see **uofi.tax/21a1x4** [www.dol.gov/agencies/whd/pandemic/ffcra-questions].[49]

> **Note.** For detailed information about the credits, including information about how to claim the credits, see **uofi.tax/21a1x5** [www.irs.gov/newsroom/covid-19-related-tax-credits-basic-faqs].

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47. *Consolidated Appropriations Act of 2021,* PL 116-260, §286, Div. N.

48. *Periods of Time for Which Credits are Available.* Jan. 28, 2021. IRS. [www.irs.gov/newsroom/periods-of-time-for-which-credits-are-available] Accessed on Mar. 1, 2021.

49. *COVID-19 Related Tax Credits: Basic FAQs.* Jan. 28, 2021. IRS. [www.dol.gov/agencies/whd/pandemic/ffcra-questions] Accessed on Mar. 1, 2021.

Credits for Self-Employed Individuals.[50] The CAA also extends the sick and family leave credits for eligible self-employed individuals through March 31, 2021. The refundable credits are claimed on the self-employed individual's Form 1040. Self-employed individuals claim the credits for leave taken between April 1, 2020, and December 31, 2020, on their 2020 Forms 1040 and for leave taken between January 1, 2021, and March 31, 2021, on their 2021 Forms 1040.

As mentioned earlier, average daily SE income is used to calculate both credits. Under the FFCRA, **average daily SE income** is defined as the individual's net earnings from self-employment for the tax year divided by 260. The CAA allows self-employed individuals to elect to calculate average daily SE income using the **prior** tax year instead of the current tax year.[51] The self-employed individual makes this election when filing their 2020 or 2021 Form 1040 by entering the prior-year net earnings on line 7 of Form 7202, *Credits for Sick Leave and Family Leave for Certain Self-Employed Individuals,*[52] shown on the following page.

The self-employed individual can fund the qualified sick and family leave equivalent amount by taking into account the credit to which the individual is entitled in determining required estimated tax payments. Therefore, a self-employed individual can reduce payments of estimated income taxes that they would otherwise be required to make if the individual was not entitled to the credit on their Form 1040.

50. *Special Issues for Employees.* Jan. 28, 2021. IRS. [www.irs.gov/newsroom/special-issues-for-employees#specific-provisions-related-self-employed-individuals] Accessed on Mar. 1, 2021.

51. *Consolidated Appropriations Act of 2021,* PL 116-260, §287, Div. N.

52. Instructions for Form 7202.

Form **7202**

Department of the Treasury
Internal Revenue Service

Credits for Sick Leave and Family Leave for Certain Self-Employed Individuals

▶ Attach to Form 1040, 1040-SR, or 1040-NR.

▶ Go to *www.irs.gov/Form7202* for instructions and the latest information.

OMB No. 1545-0074

2020

Attachment Sequence No. **202**

Name of person with self-employment income (as shown on Form 1040, 1040-SR, or 1040-NR)

Social security number of person with self-employment income

Part I Credit for Sick Leave for Certain Self-Employed Individuals

1	Number of days you were unable to perform services as a self-employed individual because of certain coronavirus-related care you required. See instructions	1	
2	Number of days you were unable to perform services as a self-employed individual because of certain coronavirus-related care you provided to another. (Do not include days you included in line 1.) See instructions	2	
3	If you are filing a fiscal year return, see instructions; otherwise enter 10	3	
4	Enter the smaller of line 1 or line 3	4	
5	Subtract line 4 from line 3	5	
6	Enter the smaller of line 2 or line 5	6	
7	Net earnings from self-employment (see instructions)	7	
8	Divide line 7 by 260 (round to nearest whole number)	8	
9	Enter the smaller of line 8 or $511	9	
10	Multiply line 4 by line 9	10	
11	Multiply line 8 by 67% (0.67)	11	
12	Enter the smaller of line 11 or $200	12	
13	Multiply line 6 by line 12	13	
14	Add lines 10 and 13	14	
15	Amount of qualified sick leave wages subject to the $511 per day limit you received from an employer (see instructions)	15	
16	Amount of qualified sick leave wages subject to the $200 per day limit you received from an employer (see instructions)	16	
	If line 15 and line 16 are both zero, skip to line 24 and enter the amount from line 14.		
17	Add line 13 and line 16	17	
18	Enter the smaller of line 17 or $2,000	18	
19	Subtract line 18 from line 17	19	
20	Add lines 10, 15, and 18	20	
21	Enter the smaller of line 20 or $5,110	21	
22	Subtract line 21 from line 20	22	
23	Add line 19 and line 22	23	
24	Subtract line 23 from line 14. If zero or less, enter -0-. Enter here and include on Schedule 3 (Form 1040), line 12b	24	

Part II Credit for Family Leave for Certain Self-Employed Individuals

25	Number of days you were unable to perform services as a self-employed individual because of certain coronavirus-related care you provided to a son or daughter. (Do not enter more than 50 days.) See instructions	25	
26	Net earnings from self-employment (see instructions)	26	
27	Divide line 26 by 260 (round to nearest whole number)	27	
28	Multiply line 27 by 67% (0.67)	28	
29	Enter the smaller of line 28 or $200	29	
30	Multiply line 25 by line 29	30	
31	Amount of qualified family leave wages you received from an employer (see instructions)	31	
	If line 31 is zero, skip to line 35 and enter the amount from line 30.		
32	Add line 30 and line 31	32	
33	Enter the smaller of line 32 or $10,000	33	
34	Subtract line 33 from line 32	34	
35	Subtract line 34 from line 30. If zero or less, enter -0-. Enter here and include on Schedule 3 (Form 1040), line 12b	35	

For Privacy Act and Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 56395K Form **7202** (2020)

ARPA

NEW LAW[53]

The ARPA made several changes to the paid sick and family leave credits and **extended the credits** for two calendar quarters. Therefore, the revisions apply to qualified leave wages paid for the period **beginning April 1, 2021, and ending on September 30, 2021.**

Eligible Employer

Under the ARPA, an eligible employer for purposes of the credit is any business with fewer than 500 employees, including tax-exempt organizations. Federal governmental employers are generally not eligible employers, except for organizations exempt from tax under §501(a).[54] However, state and local governmental employers **are** eligible employers.

Credit for Paid Sick Leave

In addition to the six conditions that require eligible employers to provide employees with paid sick leave (listed earlier), the ARPA allows paid sick leave when the employee obtains a COVID-19 vaccine or for an illness related to immunization, or for leave taken while waiting for COVID-19 test results. This applies to wages paid for leave from April 1, 2021, through September 30, 2021.

The tax credit for paid sick leave wages is equal to the sick leave wages paid for reasons related to COVID-19 for up to two weeks (or 80 hours). The 10-day limit on the amount of paid sick leave restarted on April 1, 2021, such that any paid sick leave taken prior to this date is not considered for purposes of this limit.[55]

The sick leave wages are limited to $511 per day and a total of $5,110, at 100% of the employee's regular pay rate. This applies to sick leave taken when the employee is unable to work for any of the following reasons.

1. The employee is under a federal, state, or local quarantine or isolation order related to COVID-19.
2. The employee has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
3. The employee experiences symptoms of COVID-19 and seeks a medical diagnosis, or the employee seeks or awaits the results of a diagnostic test or a medical diagnosis of COVID-19, or the employee obtains immunization for COVID-19 or is recovering from an illness, injury, disability, or other condition related to immunization.

An employee who cannot work for any of the following reasons is entitled to paid sick leave for up to two weeks (up to 80 hours) at two-thirds of the employee's regular pay rate or, if higher, the federal minimum wage or any applicable state or local minimum wage. The maximum allowable amount is $200 per day, or a total of $2,000.

1. The employee cares for an individual who is subject to a federal, state, or local quarantine or isolation order related to COVID-19 or has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
2. The employee cares for their child if the child's school or place of care has been closed or the childcare provider is unavailable due to COVID-19 precautions.
3. The employee experiences any other substantially similar condition specified by HHS.

The credit is increased by allocable health plan expenses, contributions for collectively bargained benefits, and social security and Medicare taxes paid on the wages, up to the daily and total caps.

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53. *American Rescue Plan Act,* PL 117-2, §§9641, 9642, and 9643; *Present Law and Background on Dependent Care and Paid Leave (JCX-19-21).* Apr. 19, 2021. Joint Committee on Taxation. [www.jct.gov/publications/2021/jcx-19-21/] Accessed on May 12, 2021; *Under the American Rescue Plan, employers are entitled to tax credits for providing paid leave to employees who take time off related to COVID-19 vaccinations.* May 11, 2021. IRS. [www.irs.gov/newsroom/employer-tax-credits-for-employee-paid-leave-due-to-covid-19] Accessed on May 13, 2021.

54. IRC §3131(f)(5), added by *American Rescue Plan Act,* PL 117-2.

55. IRC §3131(b)(2)(B), added by *American Rescue Plan Act,* PL 117-2.

Credit for Paid Family Leave

As was the case under prior legislation, **qualified family leave wages** are wages that eligible employers must pay eligible employees for periods of leave taken for any of the same six reasons allowed for paid sick leave. These reasons now include periods during which the employee was obtaining a COVID-19 vaccination or for illness related to immunization, or for leave taken while waiting for COVID-19 test results.

The amount of the family leave is two-thirds of the employee's regular pay, up to a maximum of $200 per day, and an aggregate of $12,000 for all quarters after March 31, 2021. An employee is therefore entitled to up to 12 weeks (or 60 days) of qualifying leave for purposes of the family leave credit.

Note. Under the CAA, an employee's paid family leave was limited to an aggregate total of $10,000. At a maximum of $200 per day, the employee was therefore entitled to up to 10 weeks (or 50 days) of qualifying family leave.

The amount of the credit is increased by allocable health plan expenses, contributions for collectively bargained benefits, and social security and Medicare taxes paid on the wages, up to the daily and total caps.

Claiming the Credits

Employers report their total paid sick and family leave wages for each quarter on their federal employment tax return (e.g., Form 941).

In anticipation of claiming the credits on their quarterly employment tax return, eligible employers can retain the federal employment taxes that they otherwise would have deposited, including federal income tax withheld from employees, the employees' share of social security and Medicare taxes, and the employer's share of social security and Medicare taxes for all employees up to the amount of credit for which they are eligible.

If an eligible employer does not have sufficient federal employment taxes to cover amounts provided for sick and family leave wages (plus allocable health plan expenses, collectively bargained contributions and employer's share of social security and Medicare taxes on the leave wages), the eligible employer can request an advance of the credits by filing Form 7200.

Nondiscrimination Requirement

No credit for sick or family leave wages is allowed if the employer discriminates in favor of highly compensated employees, full-time employees, or employees on the basis of employment tenure with the employer.

Credits for Self-Employed Individuals

The ARPA also extends the sick and family leave credits for eligible self-employed individuals through September 30, 2021. The refundable credits are claimed on the self-employed individual's 2021 Form 1040.

Eligible self-employed individuals can claim the tax credit for paid sick leave if the self-employed individual is unable to work or telework for any of the following reasons.

1. The self-employed individual is under a federal, state, or local quarantine or isolation order related to COVID-19.
2. The self-employed individual has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
3. The self-employed individual experiences symptoms of COVID-19 and seeks a medical diagnosis, or seeks or awaits the results of a diagnostic test or a medical diagnosis of COVID-19, or the employee obtains immunization for COVID-19 or is recovering from an illness, injury, disability, or other condition related to immunization.
4. The self-employed individual cares for an individual who is subject to a federal, state, or local quarantine or isolation order related to COVID-19 or has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
5. The self-employed individual cares for their child if the child's school or place of care has been closed, or the childcare provider is unavailable due to COVID-19 precautions.
6. The self-employed individual experiences any other substantially similar condition specified by the secretary of HHS.

If an eligible self-employed individual is unable to work or telework because of a circumstance described in items 1–3 above, the **qualified sick leave equivalent amount** is equal to the number of days (up to a maximum of 10 days) during the tax year that the individual cannot perform services in the applicable trade or business for one of those three reasons, multiplied by the lesser of the following.

- $511
- 100% of the individual's average daily SE income for the tax year

If an eligible self-employed individual is unable to work or telework because of a circumstance described in items 4–6 above, the **qualified sick leave equivalent amount** is equal to the number of days (up to a maximum of 10 days) during the tax year that the individual cannot perform services in the trade or business for one of those three reasons, multiplied by the lesser of the following.

- $200
- 67% of the individual's average daily SE income for the tax year

The qualified **family leave equivalent amount** for an eligible self-employed individual is an amount equal to the number of days (up to 60) during the tax year that the self-employed individual cannot perform services for which they would be entitled to paid family leave if the individual were employed by an eligible employer (described earlier), multiplied by the lesser of the following.

- $200
- 67% of the average daily SE income of the individual for the tax year

As was the case under prior legislation, **average daily SE income** is defined as the individual's net earnings from self-employment for the tax year divided by 260. The ARPA allows self-employed individuals to elect to calculate average daily SE income using the **prior** tax year instead of the current tax year.

REPORTING OF THIRD-PARTY NETWORK TRANSACTIONS

OLD LAW

A **third-party settlement organization** is a central organization that is contractually obligated to make payments to participating payees (i.e., a merchant or business) in a third-party payment network. **Participating payees** include any person who accepts payments from a third-party settlement organization in settlement of a transaction.[56] Characteristics of a **third-party payment network** include the following.[57]

- The existence of a central organization with whom a substantial number of providers of goods and services (who are not related to the central organization) have established accounts
- An agreement between the central organization and the providers to settle transactions between the providers and purchasers
- The establishment of standards and mechanisms for settling such transactions
- The guarantee of payment in settlement of such transactions

Third-party settlement organizations are required to report the gross reportable transactions of the businesses to which they make payments if the payee exceeds a de minimis transaction volume and dollar threshold.[58] Specifically, if payments to a participating payee **exceed $20,000 and 200 transactions** during a calendar year, the third-party settlement organization must report the gross amounts to the IRS on Form 1099-K, *Payment Card and Third Party Network Transactions.*[59]

ARPA

NEW LAW[60]

The ARPA modifies the de minimis exception for third-party settlement organizations. Such organizations are required to report third-party network transactions of any participating payee if the dollar amount of such transactions for a calendar year **exceeds $600.** This modification of the reporting requirements applies to calendar years beginning after December 31, 2021.

The ARPA also clarifies that reporting is not required on transactions that are not for goods or services. This clarification applies to transactions after March 11, 2021.

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56. IRC §6050W(d)(1)(A)(ii).

57. *Third Party Network Transactions FAQs.* Aug. 17, 2020. IRS. [www.irs.gov/payments/third-party-network-transactions-faqs] Accessed on May 6, 2021; IRC §6050W(d)(3).

58. *Third Party Network Transactions FAQs.* Aug. 17, 2020. IRS. [www.irs.gov/payments/third-party-network-transactions-faqs] Accessed on May 6, 2021.

59. *General FAQs on Payment Card and Third-Party Network Transactions.* May 4, 2021. IRS. [www.irs.gov/payments/general-faqs-on-new-payment-card-reporting-requirements] Accessed on May 6, 2021.

60. *American Rescue Plan Act,* PL 117-2, §9674.

TREATMENT OF STUDENT LOAN FORGIVENESS

OLD LAW[61]

A taxpayer's gross income generally includes a discharge of the taxpayer's indebtedness. However, a taxpayer's gross income does not include any amount from the forgiveness of certain student loans in the following circumstances.[62]

- The taxpayer works for a certain period in certain professions for any of a broad class of employers.
- The loans are made by educational organizations (and certain tax-exempt organizations if the loan is refinanced) if the loan proceeds are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans and the student is not employed by the lender organization.
- The loan repayment amount is made under the National Health Service Corps loan repayment program or certain state loan repayment programs that are intended to provide for the increased availability of healthcare services in underserved or health professional shortage areas.

TCJA In addition, the TCJA modified the exclusion of student loan discharges from gross income by allowing exclusions of certain discharges because of the **death or the total and permanent disability** of the student. This provision applies to discharges of loans after December 31, 2017, and before January 1, 2026.

Loans eligible for the exclusion under the TCJA are those made by:

- The United States (or an instrumentality or agency thereof);
- A state (or any political subdivision of a state);
- Certain tax-exempt public benefit corporations that control a state, county, or municipal hospital and whose employees have been deemed to be public employees under state law;
- An educational organization that originally received the funds from which the loan was made from the United States, a state, or a tax-exempt public benefit corporation; or
- Private education loans as defined in section 140(7) of the Consumer Protection Act.

ARPA

NEW LAW[63]

The ARPA expands the exclusion for student loan discharges. This provision applies to **discharges after December 31, 2020, and before January 1, 2026,** for the following types of student loans.

- Any loan provided expressly for postsecondary educational expenses if the loan was made, insured, or guaranteed by one of the following.
  - The United States or an instrumentality or agency thereof
  - A state, territory, or possession of the United States or the District of Columbia, or any political subdivision thereof
  - An eligible educational institution (as defined in IRC §25A)

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61. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/JointExplanatoryStatement.pdf] Accessed on May 6, 2021; *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law.* Sherlock, Molly F. and Marples, Donald J. Feb. 6, 2018. Congressional Research Service. [fas.org/sgp/crs/misc/R45092.pdf] Accessed on May 6, 2021.

62. IRC §108(f).

63. *American Rescue Plan Act,* PL 117-2, §9675.

- Any private educational loan made by a financial institution, a federal credit union, or any other person engaged in the business of soliciting, making, or extending private education loans.
- Any loan made by any educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on if such loan is made under one of the following.
    - An agreement with an entity or private education lender under which the funds from which the loan was made were provided to the educational organization
    - A program of the educational organization that is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by students are for or under the direction of a governmental unit or §501(c)(3) tax-exempt organization
- Any loan made by an educational organization or a tax-exempt organization to refinance a loan to an individual to assist the individual in attending any educational organization but only if the refinancing loan is pursuant to a program designed to encourage students to serve in occupations with unmet needs or in areas with unmet needs.

Observation. The ARPA provision temporarily excludes from gross income qualifying student loans that are forgiven for almost any reason after December 31, 2020, and before January 1, 2026.[64]

CHILD TAX CREDIT

OLD LAW[65]

A taxpayer can claim a nonrefundable child tax credit (CTC) of up to $2,000 per qualifying child. The CTC begins to phase out for taxpayers with modified adjusted gross income (MAGI) over $400,000 for married filing jointly (MFJ) taxpayers, or $200,000 for all other taxpayers.

To the extent that the CTC exceeds the taxpayer's tax liability, the taxpayer can qualify for a refundable additional CTC equal to 15% of earned income in excess of $2,500 (adjusted for inflation beginning in 2019). The maximum additional CTC is $1,400 per qualifying child.

A qualifying child is generally an individual who has not attained age 17 during the tax year.

ARPA

NEW LAW[66]

The ARPA makes several changes to the CTC. **These changes only apply to the 2021 tax year.**

Age Limit

The ARPA changes the age limit for a qualifying child from 16 to 17.

64. *Higher Education Tax Benefits: Brief Overview and Budgetary Effects.* Crandall-Hollick, Margot L. May 26, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/R/R41967] Accessed on Jun. 7, 2021.

65. IRC §24.

66. *American Rescue Plan Act,* PL 117-2, §9611; *The Child Tax Credit: Temporary Expansion for 2021 Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2).* Crandall-Hollick, Margot L. May 12, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IN/IN11613] Accessed on Jun. 7, 2021.

Fully Refundable

The ARPA eliminates the additional CTC limit of $1,400 per qualifying child. The CTC is now fully refundable. In addition, the full amount of the credit is available to eligible taxpayers with **no earned income.**

Increased Credit Amount

The ARPA increases the maximum amount of the CTC to $3,600 for a child who is five years old or younger. The maximum amount of the CTC is $3,000 for a child who is 6–17 years old. The increase in the maximum credit amount of $1,600 for younger children (i.e., from $2,000 before the ARPA to $3,600 under the ARPA) and $1,000 for older children (i.e., from $2,000 to $3,000) phases out at a 5% rate when the taxpayer's income exceeds $75,000 for single or married filing separately (MFS) taxpayers, $112,500 for head of household (HoH) taxpayers, and $150,000 for MFJ taxpayers. The credit phase out begins for taxpayers with income that exceeds $200,000 ($400,000 for MFJ) and phases out completely for taxpayers with income that exceeds $220,000 ($440,000 for MFJ).

Advance Payment of Credit

Under the ARPA, half of the expected CTC can be paid in equal periodic payments beginning after July 1, 2021. **No advance payments will be made after December 31, 2021.** Taxpayers who receive advance payments claim the other half of the total 2021 CTC when they file their 2021 income tax return.

The advance payments of the CTC are estimated based on the taxpayer's 2020 income tax information. If 2020 information is not available, 2019 information is used. An online portal for taxpayers to update the following information became available in July 2021.[67]

- Change in the number of the taxpayer's qualifying children
- Change in the taxpayer's marital status
- Significant change in the taxpayer's income
- Any other factor that the Secretary of the Treasury may provide

In addition, the taxpayer can use the portal to elect not to receive advance payments of the CTC.

If a taxpayer received more advance payments than they are eligible for because their income, filing status, or number of children changed, the taxpayer generally is required to repay the excess credit when they file their 2021 tax return. The credit can be repaid either by reducing the taxpayer's 2021 tax refund or paying the balance due to the IRS.

However, if a taxpayer received an incorrect amount of advance payment because of a reduction in the number of qualifying children, up to $2,000 per child of the advance payment does not have to be repaid (safe harbor amount). The safe harbor amount phases down ratably as income increases. Single or MFS taxpayers with 2021 income below $40,000, HoH taxpayers with 2021 income below $50,000, and MFJ taxpayers with 2021 income below $60,000 do not have to repay any portion of the advance payment.

Note. Page 6 of the paper *The Child Tax Credit: Temporary Expansion for 2021 Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2),* prepared by the Congressional Research Service, shows the steps for reconciling advance payments of the CTC with the allowed credit on a taxpayer's 2021 tax return when advance payments are based on an incorrect number of qualifying children. This can be found at **uofi.tax/21a1x6** [crsreports.congress.gov/product/pdf/IN/IN11613].[68]

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67. *2021 Child Tax Credit and Advance Child Tax Credit Payments — Topic A: General Information.* Jul. 15, 2021. IRS. [www.irs.gov/credits-deductions/2021-child-tax-credit-and-advance-child-tax-credit-payments-topic-a-general-information] Accessed on Jul. 20, 2021.

68. *The Child Tax Credit: Temporary Expansion for 2021 Under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2).* Crandall-Hollick, Margot L. May 12, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IN/IN11613] Accessed on Jun. 7, 2021.

Note. For more discussion on the advanced child tax credit (ACTC), see the 2021 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Individual Taxpayer Issues.

Practitioner Planning Tip

Tax practitioners may encounter clients who claimed full ACTC, partial, none, or some of each. This could be a good reason to encourage taxpayers to establish their personal IRS online account. The portal web address is **uofi.tax/21a1x7** [sa.www4.irs.gov/ola].

MODIFICATION OF CHILD AND DEPENDENT CARE CREDIT

OLD LAW[69]

A taxpayer may be able to claim a **nonrefundable** credit for child and dependent care expenses if they pay someone to care for one or more qualifying person. A **qualifying person** is the taxpayer's dependent who is under age 13 when the care was provided or for their spouse or dependent who is unable to care for themself and who lived with the taxpayer for more than half the year. The credit can be up to 35% of employment-related expenses, which must be paid so the taxpayer can work or look for work.

To claim the credit, the taxpayer (and their spouse, if married) must have earned income during the year. **Earned income** includes wages, salaries, tips, other taxable employee compensation, and net SE earnings.

A maximum of $3,000 of employment-related expenses can be used to calculate the credit for one qualifying person, or $6,000 for two or more qualifying persons. This is a yearly limit that applies regardless of the length of time during the year the taxpayer has a qualifying person in their household.

The applicable amount of employment-related expenses is multiplied by the applicable percentage to calculate the amount of the credit. The **applicable percentage** is 35% reduced (but not below 20%) by 1% for each $2,000 (or fraction thereof) by which the taxpayer's AGI exceeds $15,000.[70] Therefore, when the taxpayer's income is $43,000 or above, the applicable percentage is 20%. The phase-out threshold and the amount of expenses that qualify for the credit are not indexed for inflation.

Employment-related expenses are amounts paid for the following expenses, but only if such expenses are incurred to enable the taxpayer to be gainfully employed for any period during which the taxpayer has one or more qualifying persons.[71]

- Expenses for household services
- Expenses for the care of a qualifying person

69. IRS Pub. 503, *Child and Dependent Care Expenses*; IRC §21; Present Law and Background on Dependent Care and Paid Leave (JCX-19-21). Apr. 19, 2021. Joint Committee on Taxation. [www.jct.gov/publications/2021/jcx-19-21/] Accessed on Apr. 30, 2021.

70. IRC §21(a)(1).

71. IRC §21(b)(2)(A).

The amount of employment-related expenses used to calculate the credit cannot be more than:

- The taxpayer's earned income for the year if they are single at the end of the year, or
- The smaller of the taxpayer or their spouse's earned income for the year if they are married at the end of the year. (If the taxpayer was married during the year, the spouse's earned income for the entire year is taken into account.)

Example 4. Jimmy and Inez were married on December 3, 2020. Jimmy's earned income for 2020 was $35,000. Inez's earned income for the year was $2,000. Jimmy paid employment-related expenses of $3,000 for the care of his 5-year-old son and qualified to claim the child and dependent care credit. The amount of expenses used to calculate his credit is limited to $2,000, which is the smaller of his earned income or Inez's earned income.

An employer can provide nontaxable childcare assistance to employees under a dependent care assistance program. A **dependent care assistance program** is a written employer plan that provides dependent care assistance for employees. A dependent care flexible spending arrangement (FSA) is a type of dependent care assistance program.

Taxpayers who receive dependent care benefits from their employer are subject to a reduction in the amount of employment-related expenses used to calculate the child and dependent care credit. **Dependent care benefits** include the following.

- Amounts an employer paid directly to the taxpayer or a care provider for the care of the taxpayer's qualifying person while they work
- The fair market value (FMV) of care in a daycare facility provided or sponsored by the taxpayer's employer
- Pre-tax contributions the taxpayer made under a dependent care FSA

If an employer provides dependent care benefits under a qualified plan, the taxpayer may be able to exclude these benefits from their income. If the taxpayer excludes dependent care benefits from their income, the amount of the excluded benefits:

- Is not included in the taxpayer's employment-related expenses, and
- Reduces the applicable dollar limit for the child and dependent care credit.

The maximum amount that can be excluded from an employee's gross income under a dependent care assistance program is **$5,000 ($2,500 for MFS taxpayers).**

Example 5. Polly is a widow with a 4-year-old daughter. She earned $24,000 in 2020. Polly pays employment-related expenses of $2,900 for the care of her daughter and qualifies to claim the child and dependent care credit. Her employer pays an additional $1,000 under a qualified dependent care benefit plan. The $1,000 is excluded from Polly's income.

The 2020 limit for employment-related expenses is $3,000 for one qualifying person, but Polly calculates her credit on only $2,000 of the $2,900 employment-related expenses she paid. This is because the $3,000 of maximum allowable expenses for one qualifying person is reduced by the $1,000 of dependent care benefits that Polly excludes from income.

Example 6. Charlotte and Nathan are married and both are employed. For 2020, Charlotte has earned income of $35,000 and Nathan has earned income of $15,000. They have two children who are ages 2 and 4, and the children attend a licensed daycare facility. Charlotte's employment-related expenses are $6,000 for 2020.

Charlotte's employer has a dependent care assistance program as part of its cafeteria plan that allows employees to make pre-tax contributions to a dependent care FSA. In 2020, Charlotte elected to take the maximum $5,000 exclusion from her salary to cover dependent care expenses through this program.

Although the dollar limit for Charlotte's employment-related expenses is $6,000 (for two qualifying persons), Charlotte calculates the child and dependent care credit on only $1,000 of the $6,000 employment-related expenses paid. This is because the $6,000 maximum allowable expenses for two qualifying persons is reduced by the $5,000 of dependent care benefits excluded from Charlotte's income.

Note. For more information about the exclusion of employer-provided dependent care benefits from income, see IRS Pub. 503, *Child and Dependent Care Expenses.*

ARPA

NEW LAW[72]

The ARPA expands the child and dependent care credit for the 2021 tax year only. For 2021, the credit is **refundable** for taxpayers who have a principal place of abode in the United States for more than half the tax year. For MFJ taxpayers, the credit is refundable if at least one spouse satisfies the principal place of abode requirement. A taxpayer who does not satisfy this requirement may be able to claim a nonrefundable credit.

The amount of the credit for 2021 is increased to a maximum of **50% of employment-related expenses,** up to a limit of **$8,000 for one qualifying person** and **$16,000 for two or more qualifying persons.** Therefore, the maximum credit is $4,000 for one qualifying person and $8,000 for two or more qualifying persons.

The 50% maximum credit rate is subject to a 2-part phaseout, as follows.

1. The 50% rate is reduced, but not below 20%, by 1% for each $2,000 (or fraction thereof) of adjusted gross income (AGI) above $125,000.
2. The 20% rate is reduced, but not below zero, by 1% for each $2,000 (or fraction thereof) of AGI above $400,000.

Observation. The credit rate is 20% for taxpayers with AGI between $183,000 and $400,000. For taxpayers with AGI above $438,000, the credit is fully phased out.

In addition, the ARPA increases the exclusion for employer-provided dependent care assistance from $5,000 to **$10,500 ($5,250 for MFS taxpayers).** This increased exclusion **only applies to the 2021 tax year.**

72. *American Rescue Plan Act,* PL 117-2, §§9631 and 9632; *Present Law and Background on Dependent Care and Paid Leave (JCX-19-21).* Apr. 19, 2021. Joint Committee on Taxation. [www.jct.gov/publications/2021/jcx-19-21/] Accessed on Apr. 30, 2021.

EXPANDED PREMIUM TAX CREDIT

OLD LAW

Individuals who purchase coverage through the Health Insurance Marketplace (Marketplace) may be entitled to the premium tax credit (PTC) (also called the premium assistance credit). The PTC is available to qualifying taxpayers with household incomes between 100 and 400% of the federal poverty guidelines for the applicable family size who do not receive coverage through either the taxpayer's employer or the spouse's employer. Taxpayers with incomes above 400% of the federal poverty guidelines do not qualify for the PTC.[73]

One of the factors used to calculate the amount of PTC to which the taxpayer is entitled is the cost of the "second lowest-cost silver plan" that is available to the taxpayer in the Marketplace.[74] The second lowest-cost silver plan is referred to as the **applicable benchmark plan.[75]**

The taxpayer's household income is multiplied by the applicable percentage to arrive at the taxpayer's annual required share of premiums for the benchmark plan. The applicable percentage depends on where the taxpayer's household income falls on a sliding scale.[76]

The sliding scale is tiered. A lower and upper applicable percentage define each tier. The applicable percentages are adjusted annually to reflect rates of premium growth relative to growth in the consumer price index.[77] The sliding scale's tiers and the 2021 applicable percentages for each tier are summarized as follows.[78]

Household Income Percentage of Federal Poverty Line	Lower Applicable Percentage	Upper Applicable Percentage
Less than 133%	2.07%	2.07%
At least 133% but less than 150%	3.10%	4.14%
At least 150% but less than 200%	4.14%	6.52%
At least 200% but less than 250%	6.52%	8.33%
At least 250% but less than 300%	8.33%	9.83%
At least 300% but not more than 400%	9.83%	9.83%

Note. The 2021 federal poverty guideline income amounts can be found at **uofi.tax/21a1x8** [aspe.hhs.gov/2021-poverty-guidelines].

The taxpayer's PTC is the lesser of:

1. The premiums paid, or
2. The cost of the applicable benchmark plan available to the taxpayer minus the required annual contribution for healthcare.

73. IRC §36B.
74. IRC §36B(b)(2)(B)(i).
75. Treas. Reg. §1.36B-3(f).
76. Treas. Reg. §1.36B-3.
77. Treas. Reg. §1.36B-3(g).
78. Rev. Proc. 2020-36, 2020-32 IRB 243.

Example 7. Paige Turner is a single taxpayer with no dependents. She lives in Illinois. Her 2021 income is \$25,760, which is exactly 200% of the federal poverty income guideline for a single individual.[79] This places Paige at the bottom of the fourth income tier (shown previously). Her applicable percentage is therefore 6.52%. The maximum premium Paige is required to pay for coverage is \$1,680 (\$25,760 × 6.52%).

The annual premium for the second lowest-cost silver plan available to Paige in the Illinois Marketplace is \$5,000. The amount of PTC available to Paige for 2021 is \$3,320 (\$5,000 cost of applicable benchmark plan – \$1,680 maximum premium Paige is expected to pay).

Reconciliation of PTC

The Marketplace makes advance payments of the PTC during the year to the taxpayer's insurance provider. These advance payments pay for part or all of the premiums for a qualified health plan covering the taxpayer. Eligibility for the advance payments is based on the Marketplace's estimate of the PTC the taxpayer will be able to qualify for on their tax return.

If advance payments of the PTC were paid for the taxpayer or an individual in the taxpayer's family, the taxpayer must complete Form 8962, *Premium Tax Credit (PTC),* to reconcile the advance payments with the PTC. If the advance payments are less than the PTC, the taxpayer receives a credit for the difference, which reduces their balance due or increases their refund. If the advance payments are more than the PTC, the taxpayer has excess advance payments and owes the excess as an additional income tax liability.[80]

However, for taxpayers with household incomes of less than 400% of the federal poverty income guidelines for their family size, there is a cap on the amount of additional tax liability that is imposed to recover any excess advance credit payments. The cap for these taxpayers is implemented according to the following table. The amounts in the table are adjusted annually to reflect changes in the consumer price index.[81]

Household Income Percentage of Poverty Income Guideline	Maximum Additional Tax Liability for Single Taxpayers (Other than Surviving Spouses and HoH)	Maximum Additional Tax Liability for All Other Taxpayers
Less than 200%	\$ 325	\$ 650
At least 200% but less than 300%	800	1,600
At least 300% but less than 400%	1,350	2,700

79. *2021 Poverty Guidelines.* Jan. 26, 2021. U.S. Department of Health & Human Services. [aspe.hhs.gov/2021-poverty-guidelines] Accessed on May 10, 2021.

80. IRS Pub. 974, *Premium Tax Credit (PTC);* Treas. Reg. §1.36B-4(a)(1).

81. Treas. Reg. §1.36B-4(a)(3); Rev. Proc. 2020-45, 2020-46 IRB 1016.

ARPA **NEW LAW**[82]

Temporary Modification of Limitations on PTC Reconciliation[83]

The ARPA suspended the requirement to repay excess advance payments of the PTC for the **2020 tax year only.**

Taxpayers who filed their 2020 tax returns and reported excess advance payments of the PTC before the law change are not required to file an amended return or take any other action to get a refund of this amount. The IRS reduces the excess advance payment amount to zero with no further action needed by the taxpayer.

If a taxpayer's PTC calculated on their 2020 return is more than the advance payments of the PTC, the difference is a net PTC. Taxpayers claiming a net PTC must file Form 8962 when they file their 2020 tax return. If a taxpayer filed a 2020 tax return claiming a net PTC but did not file Form 8962, they will receive an IRS notice asking for more information to process the 2020 return and issue any applicable refund due to the taxpayer.[84]

PTC Percentages

The ARPA amends the applicable percentages for **2021 and 2022** as shown in the following table.

Household Income Percentage of Federal Poverty Line	Lower Applicable Percentage	Upper Applicable Percentage
Up to 150%	0.0%	0.0%
150% up to 200%	0.0%	2.0%
200% up to 250%	2.0%	4.0%
250% up to 300%	4.0%	6.0%
300% up to 400%	6.0%	8.5%
400% and higher	8.5%	8.5%

As shown in the table, taxpayers with household income above 400% of the federal poverty guideline are **for the first time** eligible for the PTC only in 2021 and 2022. Moreover, the applicable percentages for taxpayers at all income levels are reduced, which increases the amount of the PTC.

> **Example 8.** Use the same information as **Example 7**, except Paige's PTC is calculated under the provisions of the ARPA. Paige's applicable percentage is now 2.0% and the maximum amount she is expected to pay is \$515 (\$25,760 × 2.0%). The amount of the PTC available to Paige under the ARPA for 2021 is \$4,485 (\$5,000 cost of benchmark plan – \$515 maximum premium).

PTC for Individuals Receiving Unemployment Compensation in 2021[85]

A special rule applies to individuals who receive or have been approved to receive unemployment compensation for any week beginning in 2021. For the 2021 tax year only, such taxpayer's household income is not taken into account to the extent it exceeds 133% of the federal poverty guideline (the income level to qualify for Medicaid coverage)[86] for the applicable family size.

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82. *American Rescue Plan Act,* PL 117-2, §§9661, 9662, and 9663.

83. *American Rescue Plan Act,* PL 117-2, §9662; *Premium Tax Credit: Claiming the Credit and Reconciling Advance Credit Payments.* May 7, 2021. IRS. [www.irs.gov/affordable-care-act/individuals-and-families/premium-tax-credit-claiming-the-credit-and-reconciling-advance-credit-payments] Accessed on May 11, 2021.

84. *More details about changes for taxpayers who received advance payments of the 2020 Premium Tax Credit.* May 11, 2021. IRS. [www.irs.gov/newsroom/more-details-about-changes-for-taxpayers-who-received-advance-payments-of-the-2020-premium-tax-credit] Accessed on May 11, 2021.

85. *American Rescue Plan Act,* PL 117-2, §9663.

86. *Medicaid Expansion and What It Means For You.* Healthcare.gov [www.healthcare.gov/medicaid-chip/medicaid-expansion-and-you/] Accessed on Jul. 30, 2021.

The taxpayer is not treated as having received (or been approved to receive) unemployment compensation for any week in 2021 unless the taxpayer provides self-attestation of the receipt or approval and such other documentation as may be required by the IRS.

Observation. Because the applicable percentage is zero for taxpayers with household incomes up to 150% of the federal poverty guideline in 2021, taxpayers who receive (or are approved to receive) unemployment compensation for any week in 2021 can obtain health insurance coverage through the Marketplace without having to pay any premiums for a benchmark plan.

ADDITIONAL 2020 RECOVERY REBATES FOR INDIVIDUALS

Note. Economic impact payments (EIP) were the terms used for the three rounds of advance payments sent to taxpayers. Recovery rebates refers to the reconciliation of the EIP payments on a taxpayer's return which may result in additional recovery rebates (but not less). The text uses the terms interchangeably.

CARES

OLD LAW[87]

The CARES Act provided a recovery rebate refundable credit for 2020. This credit is commonly called the economic impact payment or stimulus payment. Many taxpayers received an advance refund before filing a 2020 tax return.

An eligible individual was allowed a refundable credit **for the 2020** tax year equal to the sum of:

- $1,200 ($2,400 if MFJ), and
- $500 for each qualifying child of the individual.

An eligible individual is any individual other than the following.

1. Taxpayers with AGI in excess of threshold amounts
2. Dependent
3. Taxpayer without a social security number (SSN) valid for employment
4. Nonresident alien
5. Deceased individual
6. Estate or trust

Note. A batch of recovery rebate payments were sent to incarcerated persons in April 2020. After that, the IRS changed its policy and denied such payments to incarcerated individuals. However, Judge Phyllis Hamilton of the U.S. District Court for the Northern District of California ordered the IRS and the Treasury Department to cease denying such payments to individuals simply because they were incarcerated.[88] For a summary of this court case, *Scholl v. Mnuchin,* see the 2021 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 4: Rulings and Cases.

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87. *CARES Act*, PL 116-136, §2201; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Feb. 19, 2021; *Economic Impact Payment Information Center.* Apr. 15, 2021. IRS. [www.irs.gov/coronavirus/economic-impact-payment-information-center] Accessed on Jun. 22, 2021.

88. *Federal judge tells Trump administration to stop withholding $1,200 stimulus payments totaling $100 million from incarcerated.* Singletary, Michelle. Oct. 6, 2020. Washington Post. [www.washingtonpost.com/business/2020/10/06/federal-ruling-incarcerated-people-stimulus-payments/] Accessed on Feb. 20, 2021; *Recovery Rebate Credit – Topic B: Eligibility.* Feb. 9, 2021. IRS. [www.irs.gov/newsroom/recovery-rebate-credit-topic-b-eligibility] Accessed on Feb. 20, 2021.

A **qualifying child** is defined as one who meets the following requirements.[89]

1. The child is the son, daughter, stepchild, eligible foster child, brother, sister, stepbrother, stepsister, half-brother, half-sister, or a descendant of any of them.
2. The child was under age 17 at the end of the tax year and is younger than the individual eligible for the payment, or the child is permanently or totally disabled.
3. The child is claimed as a dependent on the taxpayer's tax return.
4. The child is a U.S. citizen, U.S. national, or U.S. resident alien.
5. The child lived with the individual eligible for the payment for more than half the tax year.
6. The child did not provide over half of their own support for the tax year.
7. The child has a valid SSN or adoption taxpayer identification number (ATIN).

Eligible individuals received a recovery rebate of $1,200 (or $2,400 for MFJ filers) if they had AGI up to the following amounts.

- $75,000 for individuals whose filing status was single or MFS
- $112,500 for HoH
- $150,000 for MFJ

The credit was phased out at a 5% rate if the individual's AGI was in one of the following ranges.

- $75,000–$99,000 for single and MFS filers
- $112,500–$136,500 for HoH filers
- $150,000–$198,000 for MFJ filers

SSN Required

Individuals must have a valid SSN to receive a recovery rebate payment. When spouses file jointly, both spouses must have valid SSNs to receive the full payment amount, unless either spouse is a member of the U.S. Armed Forces at any time during the tax year. In that situation, only one spouse needs to have a valid SSN to receive the full amount of the recovery rebate.[90]

CAA

> **Note.** Originally, the CARES Act provided that both spouses must have a valid SSN to receive a recovery rebate payment if they file jointly. The CAA amended this provision such that a married couple filing a joint return may be eligible for a partial credit when only one spouse has a valid SSN. If a married couple did not receive a recovery rebate payment because one of the spouses did not have a valid SSN, they can claim the credit on their 2020 tax return.[91]

In addition, a qualifying child is not taken into account for purposes of the $500 payment unless they have a valid identification number, which for this purpose is an SSN or an ATIN.

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89. *Economic Impact Payments: Qualifying Child Requirements.* Feb. 2, 2021. IRS. [www.irs.gov/newsroom/economic-impact-payments-qualifying-child-requirements] Accessed on Feb. 19, 2021.

90. *Recovery Rebate Credit — Topic B: Eligibility.* Feb. 9, 2021. IRS. [www.irs.gov/newsroom/recovery-rebate-credit-topic-b-eligibility] Accessed on Feb. 20, 2021.

91. Ibid; *CARES Act,* PL 116-260, §273(a)(3), Div. N; IRC §6428(g).

CAA

NEW LAW[92]

The CAA authorized a second round of recovery rebate payments. Eligible individuals were allowed a credit against their 2020 tax equal to the sum of the following amounts.

- $600 ($1,200 for a couple filing MFJ)
- $600 multiplied by the number of the taxpayer's qualifying children

Most taxpayers received advance payments of the recovery rebates by direct deposit, but some received checks or debit cards. Eligible taxpayers who did not receive the advance payment could claim it on their 2020 tax returns.[93]

The eligibility requirements were the same as for the first round of recovery rebate credits except that the credit eligibility and the credit amount are based on the taxpayer's 2020 tax year information. Advance recovery rebate payments were based on information from the taxpayer's 2019 return. Individuals who died prior to January 1, 2020, are not eligible for the credit.[94]

The AGI threshold amounts are the same as for the first round of payments. The credit phases out at a 5% rate if the taxpayer's AGI is in one the following ranges.

- $75,000–$87,000 for single and MFS filers
- $112,500–$124,500 for HoH filers
- $150,000–$174,000 for MFJ filers

2021 RECOVERY REBATES FOR INDIVIDUALS

ARPA

NEW LAW[95]

The ARPA provided a third round of recovery rebate payments to individuals. As was the case for the first and second round payments, most taxpayers received advance payments (EIP-3) of the 2021 recovery rebates.

An eligible individual was allowed a refundable credit equal to the sum of:

- $1,400 ($2,800 if MFJ), and
- $1,400 for each **dependent**[96] of the individual.

> **Note.** In the first and second round of payments, eligible taxpayers were eligible to receive a recovery rebate credit for each qualifying child. Under the ARPA, each of the taxpayer's dependents (including qualifying relatives) is eligible for a recovery rebate payment.

92. *CARES Act,* PL 116-260, §272, Div. N; IRC §6428.

93. IRS News Rel. 2020-280 (Dec. 29, 2020).

94. *Recovery Rebate Credit — Topic B: Eligibility.* Feb. 9, 2021. IRS. [www.irs.gov/newsroom/recovery-rebate-credit-topic-b-eligibility] Accessed on Feb. 20, 2021.

95. *American Rescue Plan Act,* PL 117-2, §9601*; COVID-19 and Direct Payments: Frequently Asked Questions (FAQs) About the Third Round of "Stimulus Checks" in the American Rescue Plan Act of 2021* (ARPA; P.L. 117-2). Crandall-Hollick, Margot L. Mar. 25, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IN/IN11604] Accessed on Apr. 22, 2021; *COVID-19 and Direct Payments: Comparison of First and Second Round of "Stimulus Checks" to the Third Round in the American Rescue Plan Act of 2021* (ARPA; P.L. 117-2). Crandall-Hollick, Margot L. Mar. 25, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IN/IN11605] Accessed on Apr. 22, 2021.

96. As defined in IRC §152.

The AGI threshold amounts under the ARPA are the same as for the first and second round of payments. However, the maximum payment amounts phase out more rapidly under the ARPA than for the first two rounds of recovery rebates. The ARPA phase-out ranges are as follows.

- $75,000–$80,000 for single and MFS filers
- $112,500–$120,000 for HoH filers
- $150,000–$160,000 for MFJ filers

Individuals who died **prior to January 1, 2021** are not eligible for the third round of rebates.

EIP-3 payments were based on information from the taxpayer's 2020 (if available) or 2019 return. For eligible individuals who are not required to file a tax return, the IRS made payments based on information available to the Treasury (e.g., information provided by the Social Security Administration, Railroad Retirement Board, or Department of Veterans Affairs).

EIP-3 payments were automatically issued to eligible households until December 31, 2021. Eligible taxpayers who do not receive the EIP-3 payments or who received less than they were entitled to based on their 2021 income and family size may receive the payment (or balance of the payment) by claiming a refundable recovery rebate credit on their 2021 tax return.

Individuals must have a valid SSN to receive a recovery rebate payment. When spouses file jointly, both spouses must generally have valid SSNs to receive the full payment amount of $2,800. If only one spouse has an SSN, only the spouse with an SSN is eligible for a recovery rebate payment. However, if either spouse is a member of the U.S. Armed Forces at any time during the tax year, only one spouse needs to have a valid SSN to receive the full amount of the recovery rebate. If an eligible individual does not have an SSN, they can still receive a recovery rebate for a qualifying child who has an SSN or ATIN.

Example 9. Regis is a nonresident alien enrolled at the University of Illinois in 2021. Regis is not eligible for an SSN, but he has a 4-year-old daughter, Tara, who was born in the United States and has an SSN. Regis files a 2021 tax return using his individual taxpayer identification number and claims the recovery rebate payment for his qualified dependent, Tara.

PREMIUM ASSISTANCE FOR COBRA CONTINUATION COVERAGE

OLD LAW[97]

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) provides group health plan continuation rights for participants and beneficiaries covered by certain group health plans. Generally, an individual who was covered by a group health plan on the day before a qualifying event occurred may be able to elect COBRA continuation coverage after that qualifying event. Such individuals are **qualified beneficiaries.** COBRA mandates that group health plans notify covered employees and their families about their rights under COBRA.

97. *FAQs About COBRA Premium Assistance Under the American Rescue Plan Act of 2021.* Apr. 7, 2021. U.S. Department of Labor. [www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/faqs/cobra-premium-assistance-under-arp.pdf] Accessed on Apr. 27, 2021.

ARPA

NEW LAW[98]

The ARPA provides COBRA premium assistance to help "assistance eligible individuals" continue their health benefits. Assistance eligible individuals are not required to pay their COBRA premiums for periods of health coverage on or after **April 1, 2021, through September 30, 2021.** Employers or plans to whom COBRA premiums are payable are entitled to refundable tax credits for the amount of the premium assistance.

An assistance eligible individual is any individual who is:[99]

- A qualified beneficiary as the result of a reduction of hours of a covered employee's employment or the involuntary termination of a covered employee's employment (other than because of an employee's gross misconduct);
- Is eligible for COBRA continuation coverage for some or all of the period beginning on April 1, 2021, through September 30, 2021; and
- Elects COBRA coverage.

A **qualified beneficiary** for this purpose is an individual who meets the following conditions.[100]

- Is covered under the group health plan on the day before the reduction in hours or involuntary termination of employment
- Loses eligibility for the coverage because of the reduction in hours or involuntary termination of employment

An individual's premium assistance can last from April 1, 2021, through September 30, 2021. However, it ends earlier if one of the following conditions applies.

- The individual becomes eligible for another group health plan (not including excepted benefits, a qualified small employer health reimbursement arrangement or a health FSA) or if they are eligible for Medicare.
- The individual reaches the end of their maximum COBRA coverage period (generally, 18 months after the employee's reduction in hours or involuntary termination).

If an individual who receives premium assistance becomes eligible for any other group health plan coverage or Medicare, they must notify the group health plan providing COBRA continuation coverage of their eligibility for the other coverage. The individual may be subject to a penalty of $250 if they fail to notify the group health plan. If the failure to notify the group health plan is fraudulent, the individual is subject to a penalty that is the greater of $250 or 110% of the premium assistance improperly received after the period of eligibility for COBRA premium assistance.[101]

COBRA premium assistance provided to eligible individuals is **excluded from their gross income** for tax purposes.[102]

The COBRA premium assistance provisions offered under the ARPA apply to all group health plans sponsored by private-sector employers or employee organizations that are subject to the COBRA rules. They also apply to plans sponsored by state or local governments subject to continuation provisions under the Public Health Service Act.

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98. *American Rescue Plan Act,* PL 117-2, §9501; *FAQs About COBRA Premium Assistance Under the American Rescue Plan Act of 2021.* Apr. 7, 2021. U.S. Department of Labor. [www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/faqs/cobra-premium-assistance-under-arp.pdf] Accessed on Apr. 27, 2021.

99. IRS Notice 2021-31, 2021-23 IRB 1173. See Q-1.

100. Ibid.

101. IRS Notice 2021-31, 2021-23 IRB 1173.

102. See IRC §139I, added by *American Rescue Plan Act,* PL 117-2.

Employers or plans to whom premiums are payable (premium payees) for COBRA continuation coverage can take a credit against the 1.45% Medicare tax imposed on employers for each calendar quarter. The amount of the credit is equal to the premiums not paid by eligible individuals for such coverage. If the amount of the credit exceeds the employer's portion of Medicare taxes, the excess amount is treated as an overpayment and will be refunded.

A premium payee claims the credit on its federal employment tax return(s) (e.g., Form 941). In anticipation of receiving the credit, the premium payee can reduce its deposits of federal employment taxes (including withheld taxes) that it would otherwise be required to deposit, up to the amount of the anticipated credit. The premium payee can request an advance of the amount of the anticipated credit that exceeds the federal employment tax deposits available for reduction by filing Form 7200. The premium payee can file the Form 7200 after the end of the payroll period in which it became entitled to the credit.[103]

Employers are **required** to reimburse premiums paid by an eligible individual for the period they are entitled to premium assistance for COBRA continuation coverage under the ARPA. Such reimbursements should be made no later than 60 days after the date on which the individual made the premium payment.

> **Note.** For more information about premium assistance for COBRA continuation coverage, see IRS Notice 2021-31.

TEMPORARY SPECIAL RULE FOR DETERMINING EARNED INCOME

OLD LAW

The amount of earned income credit (EIC) that a taxpayer qualifies for is based on a combination of factors including the number of children, the amount of earned income received during the year, and the taxpayer's filing status.[104]

TCJA As mentioned previously, under the TCJA, a taxpayer can claim a CTC of $2,000 per qualifying child. To the extent the CTC exceeds the taxpayer's tax liability, the taxpayer can qualify for a refundable additional CTC equal to 15% of earned income in excess of $2,500. Under the TCJA, the maximum refundable additional CTC is $1,400 per qualifying child for 2020.[105]

CAA

NEW LAW[106]

Under the CAA, if the earned income of a qualified individual for the 2020 tax year is less than the earned income of that individual for the 2019 tax year, the individual can elect to determine their refundable additional CTC and their EIC by substituting their earned income for 2019 for the earned income of 2020.

To make the election to determine the EIC using the taxpayer's 2019 earned income, the taxpayer enters "PYEI" and the amount of their 2019 earned income on the dotted line next to line 27 (earned income credit) on Form 1040 (2020).

To make the election to determine the additional CTC using the taxpayer's 2019 earned income, the taxpayer enters "PYEI" and the amount of their 2019 earned income on the dotted line next to line 28 (additional child tax credit) on Form 1040 (2020).

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103. IRS Notice 2021-31, 2021-23 IRB 1173.

104. *Earned Income and Earned Income Tax Credit (EITC) Tables.* Feb. 3, 2021. IRS. [www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-and-earned-income-tax-credit-eitc-tables] Accessed on Mar. 8, 2021.

105. IRC §24; Rev. Proc. 2019-44, 2019-47 IRB 1093.

106. *Consolidated Appropriations Act of 2021,* PL 116-260, §211, Div. EE; IRS Pub. 596, *Earned Income Credit (EIC);* Instructions for Schedule 8812.

Example 10. Michael and Flora have three children under the age of 16 who qualify for the additional CTC. Michael earned $36,000 in 2019, but only $2,000 in 2020 because his employer ceased operations early in the year. They had no other sources of income in either year. His earned income in 2020 was below the $2,500 threshold to qualify for the additional CTC so Michael and Flora decide to use his 2019 earnings to qualify for the additional CTC and the EIC. They have no 2020 tax liability and the EIC and additional CTC credits result in a 2020 refund of $8,584. Page 2 of their 2020 Form 1040 is shown next.

Form 1040 (2020) Page **2**

	16	**Tax** (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐			16	0
	17	Amount from Schedule 2, line 3			17	
	18	Add lines 16 and 17			18	0
	19	Child tax credit or credit for other dependents			19	
	20	Amount from Schedule 3, line 7			20	
	21	Add lines 19 and 20			21	0
	22	Subtract line 21 from line 18. If zero or less, enter -0-			22	
	23	Other taxes, including self-employment tax, from Schedule 2, line 10			23	
	24	Add lines 22 and 23. This is your **total tax** ▶			24	0
	25	Federal income tax withheld from:				
	a	Form(s) W-2	25a	0		
	b	Form(s) 1099	25b			
	c	Other forms (see instructions)	25c			
	d	Add lines 25a through 25c			25d	0
• If you have a qualifying child, attach Sch. EIC. • If you have nontaxable combat pay, see instructions.	26	2020 estimated tax payments and amount applied from 2019 return			26	
	27	Earned income credit (EIC) PYEI 36000	27	4,384		
	28	Additional child tax credit. Attach Schedule 8812 PYEI 36000	28	4,200		
	29	American opportunity credit from Form 8863, line 8	29			
	30	Recovery rebate credit. See instructions	30			
	31	Amount from Schedule 3, line 13	31			
	32	Add lines 27 through 31. These are your **total other payments and refundable credits** ▶			32	8,584
	33	Add lines 25d, 26, and 32. These are your **total payments** ▶			33	8,584
Refund	34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**			34	8,584
	35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐			35a	8,584
Direct deposit? See instructions.	▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings				
	▶ d	Account number				
	36	Amount of line 34 you want **applied to your 2021 estimated tax** ▶	36			
	37	Subtract line 33 from line 24. This is the amount you owe now				

EARNED INCOME CREDIT

OLD LAW[107]

As mentioned earlier, the amount of EIC that a taxpayer qualifies for is based on a combination of factors including the number of qualifying children, the amount of earned income received during the year, and the taxpayer's filing status.[108] The EIC increases in value as the taxpayer's earned income increases up to a certain level. It gradually decreases in value over higher income levels.

Prior to the ARPA, individuals with no qualifying children had to be at least 25 years old and no older than 64 to be eligible for the EIC.

107. *The "Childless" EITC: Temporary Expansion for 2021 under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2).* Crandall-Hollick, Margot L. May 3, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IN/IN11610] Accessed on Jun. 7, 2021; IRS Pub. 596, *Earned Income Credit (EIC).*

108. *Earned Income and Earned Income Tax Credit (EITC) Tables.* Feb. 3, 2021. IRS. [www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-and-earned-income-tax-credit-eitc-tables] Accessed on Mar. 8, 2021.

Before the ARPA was enacted, the EIC for taxpayers in 2021 with no qualifying children gradually phased in at a 7.65% rate as earned income increased until earned income reached $7,100. The credit remained at the maximum level of $543 until the taxpayer's income reached $14,820 for MFJ taxpayers, or $8,880 for other taxpayers. At income above these levels, the credit declined at a 7.65% rate and was entirely phased out when income was $21,920 for MFJ taxpayers, or $15,980 for other taxpayers.

To claim the EIC, a taxpayer's filing status must be single, MFJ, HoH, or qualifying widow(er). Taxpayers who file using the MFS filing status are not eligible for the EIC.[109]

Taxpayers cannot claim the EIC for 2021 if their investment income exceeds $3,650.[110] This amount is adjusted annually for inflation. **Investment income** includes rent and royalty income not derived in the ordinary course of a trade or business, taxable interest and dividends, tax-exempt interest, capital gain net income, and passive activity net income.

In addition, a taxpayer (and spouse, if filing a joint return) must have a valid SSN. Any qualifying child claimed on Schedule EIC, *Earned Income Credit,* also must have a valid SSN. The SSN must be valid for employment and issued before the due date of the tax return (including extensions).[111]

ARPA

NEW LAW[112]

The ARPA makes the following changes to the EIC.[113]

- Temporarily expands the eligibility for the EIC and increases the credit amount for taxpayers with no qualifying children
- Repeals the rule that an eligible taxpayer with at least one qualifying child who does not claim the EIC for one or more qualifying children because of a failure to meet the identification requirements (e.g., having a valid SSN) cannot claim the EIC
- Provides that certain married taxpayers separated from their spouse are treated as not married for purposes of the EIC if a joint return is **not** filed
- Raises the investment income maximum amount to $10,000 for tax years beginning in 2021
- Allows a taxpayer to elect to calculate their EIC for the 2021 tax year using 2019 rather than 2021 earned income, if the taxpayer's 2021 earned income is less than in 2019

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109. *Who Qualifies for the Earned Income Tax Credit (EITC).* Mar. 22, 2021. IRS. [www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/who-qualifies-for-the-earned-income-tax-credit-eitc#Valid%20Social%20Security%20Number] Accessed on Apr. 28, 2021.

110. Rev. Proc. 2020-45, 2020-46 IRB 1016.

111. *Who Qualifies for the Earned Income Tax Credit (EITC).* Mar. 22, 2021. IRS. [www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/who-qualifies-for-the-earned-income-tax-credit-eitc#Valid%20Social%20Security%20Number] Accessed on Apr. 28, 2021.

112. *American Rescue Plan,* PL 117-2, §§9621–9626.

113. *TAS Tax Tips: American Rescue Plan Act of 2021 individual tax changes summary by year.* Mar. 23, 2021. Taxpayer Advocate Service. [www.taxpayeradvocate.irs.gov/news/tas-tax-tips-american-rescue-plan-act-of-2021-individual-tax-changes-summary-by-year/] Accessed on Apr. 28, 2021.

Temporary Changes for Taxpayers with No Qualifying Children[114]

The ARPA makes temporary changes to the EIC for 2021. The rate at which the EIC phases in is increased from 7.65% to 15.3%. The maximum amount of the credit is increased from $543 to $1,502, which is attained when the taxpayer's income reaches $9,820. In addition, the income level at which the EIC begins to phase out is increased to $17,550 for MFJ taxpayers and $11,610 for unmarried taxpayers. The phase-out rate is also increased to 15.3%.

Moreover, the ARPA reduces the minimum age of eligibility from 25 to 19 for most individuals. For students attending school, the age limit is temporarily reduced from 25 to 24. For homeless youth and former foster children, the minimum age is reduced from 25 to 18. In addition, the ARPA temporarily eliminates the upper age limit so that individuals who are older than 64 are eligible for the EIC. **These changes only apply to 2021.**

Eligibility for Taxpayers Without Valid SSNs for Qualifying Children

For tax years beginning after December 31, 2020, the ARPA repeals the rule that an eligible taxpayer who does not have a valid SSN for one or more qualifying children cannot claim the EIC. Under the provision, such taxpayers can claim the EIC under the rules that apply for taxpayers with no qualifying children.

EIC Allowed for Certain Separated Spouses

For tax years beginning after 2020, a married individual is not treated as married for purposes of the EIC if they:

- Are married and do not file a joint return for the tax year;
- Reside with a qualifying child for more than half of the tax year; and
- Do not have the same principal place of residence as their spouse during the last six months of the tax year **or** have a decree or instrument of divorce or separate maintenance, written separation agreement, or other decree requiring a spouse to make payments for support or maintenance with respect to their spouse and are not a member of the same household as their spouse by the end of the tax year.

Practitioner Planning Tip

Accordingly, married taxpayers filing separate returns may be able to claim the EIC for tax years after 2020 without having to meet the more stringent requirements to claim HoH filing status.

Modification of Disqualified Investment Income

The ARPA increases the investment income limit to $10,000 for years beginning after 2020. Accordingly, taxpayers whose investment income does not exceed $10,000 are eligible for the EIC. This amount is adjusted for inflation in years beginning after 2021.

Special Rule for Determining Earned Income for 2021

If a taxpayer's earned income for 2021 is less than their earned income for 2019, they can calculate their EIC using their 2019 earned income. For taxpayers filing a joint return, the 2019 earned income is calculated using the sum of the earned income of each spouse.

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114. *The "Childless" EITC: Temporary Expansion for 2021 under the American Rescue Plan Act of 2021 (ARPA; P.L. 117-2).* Crandall-Hollick, Margot L. May 3, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IN/IN11610] Accessed on Jun. 7, 2021.

CHARITABLE CONTRIBUTIONS DEDUCTIBLE BY NON-ITEMIZERS

CARES

OLD LAW[115]

An individual's AGI is determined by subtracting certain above-the-line deductions from their gross income. These deductions include, but are not limited to, losses from the sale or exchange of property, contributions to certain individual retirement arrangements (IRAs), contributions to a qualified retirement plan by a self-employed individual, and certain education-related expenses.

An income tax deduction is allowed for charitable contributions, subject to certain limitations. The deduction allowed to individual taxpayers is generally available only if the taxpayer elects to itemize deductions.

The CARES Act allows an eligible individual to claim an above-the-line deduction of up to $300 for qualified charitable contributions made during the **2020** tax year. An eligible individual for this purpose is a taxpayer who does not itemize deductions for 2020. The $300 limit is a **per-return limit.** Therefore, married taxpayers who file a joint return (MFJ) and do not itemize deductions can deduct up to $300 in charitable contributions on the joint return.[116]

A **qualified charitable contribution** is a cash contribution for which a deduction is allowable under IRC §170.[117] Contributions of noncash property are not allowed as above-the-line charitable contributions.

Under the CARES Act provision, qualified contributions must be made to an organization described in §170(b)(1)(A), which includes churches, educational organizations, medical research organizations, hospitals, and public charities. Contributions for purposes of this provision cannot be made to a supporting organization described in IRC §509(a)(3) or to a donor-advised fund.

CAA

NEW LAW[118]

The CAA allows an individual who does not itemize deductions to claim a deduction of up to $300 for qualified charitable contributions made during the 2021 tax year. **Taxpayers filing MFJ can claim up to $600 for qualified charitable contributions made during 2021.**

The 2021 deduction available to nonitemizers is taken as an **adjustment to taxable income,** not as an adjustment to AGI, as applied to 2020 charitable contribution deductions.

> **Note.** The 2020 above-the-line charitable contribution deduction was an adjustment under IRC §62, which defines AGI. The CAA provision amends §170 (charitable contributions) for 2021 contributions. Consequently, the 2021 deduction affects taxable income rather than AGI.

115. *CARES Act,* PL 116-136, §2204; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Mar. 8, 2021.

116. *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Mar. 8, 2021.

117. See IRC §408(d)(8).

118. *Consolidated Appropriations Act of 2021,* PL 116-260, §212, Div. EE; IRC §170(p).

Example 11. George and Mary have pension income every year of $60,000 and plan on filing a joint return in 2021, as they did in 2020. They have not itemized since they paid off the mortgage on their home in 2015. Every year they contribute $600 to a §501(c)(3) charitable organization. In 2020 their total income on Line 9 of their Form 1040 was $60,000 and their AGI was reduced by $300 to $59,700 ($60,000 pension income – $300 adjustment for charitable contributions). For 2021, they expect total income to be $60,000 again. Their $600 charitable deduction does not reduce AGI for 2021. Instead, it reduces taxable income only (similar to how the qualified business income deduction was reflected on 2020 returns.)

On their 2021 tax return they expect total income of $59,400 because their $600 charitable contribution is now an adjustment to total income. They also expect their AGI to be the same amount.

Underpayments of tax that are attributable to overstatements of the charitable contribution deduction for nonitemizers are subject to an accuracy-related penalty of 50%, rather than the 20% penalty that normally applies.

Observation. This is a change from 2020. The 2021 non-itemizer charitable contribution does not reduce AGI.

MODIFICATION OF LIMITATIONS ON CHARITABLE CONTRIBUTIONS

CARES

OLD LAW[119]

Under the CARES Act, an individual taxpayer can deduct qualified contributions up to the amount by which **100%** of the taxpayer's contribution base exceeds the deduction for other charitable contributions. The **contribution base** is the taxpayer's AGI, computed without any net operating loss (NOL) carryback. Other limits may apply, depending on the type of organization to which the contribution was made and the type of property contributed. Contributions in excess of this amount are carried forward to subsequent tax years.

For C corporations, the deduction for qualified contributions is allowed for 2020 up to 25% (previously 10%) of the corporation's taxable income.[120] Contributions in excess of this amount are carried forward to subsequent tax years.

Note. Prior to the enactment of the CARES Act, individual taxpayers could deduct cash contributions up to 60% of their contribution base for contributions to organizations described in §170(b)(1)(A).[121] The charitable contribution deduction for corporations was limited to 10% of the corporation's taxable income calculated with certain adjustments. This applied to tax years 2018–2025.[122]

Charitable contributions that exceed the applicable percentage limitation may be carried forward for up to five years subject to the applicable contribution base in succeeding years.

Qualified contributions under the CARES Act are cash contributions **paid during 2020** to a charitable organization described in §170(b)(1)(A). Contributions for purposes of this provision cannot be made to a supporting organization described in §509(a)(3) or to a donor-advised fund. Contributions of noncash property are not qualified contributions. A qualified charitable contribution does not include an amount that is treated as a contribution in the tax year because it was carried forward from a prior contribution year under §§170(b)(1)(G) or (d)(1).

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119. *CARES Act*, PL 116-136, §2205; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Mar. 9, 2021.

120. IRC §170(b)(2)(A) as amended by PL116-136, §2105(a)(2)(i).

121. IRC §170(b)(1)(G)(i).

122. IRC §170(b)(2)(A).

Even though they are not qualified contributions, taxpayers may still deduct contributions of inventory, with different limits. For charitable contributions of inventory, a taxpayer's deduction is generally limited to the taxpayer's basis (which is usually cost) in the inventory, or the FMV of the inventory, if less. For certain contributions of inventory, a C corporation can claim an **enhanced deduction** equal to the **lesser** of the following.

- Basis plus half of the item's appreciation
- Two times basis

Any taxpayer engaged in a trade or business, regardless of whether the taxpayer is a C corporation, can claim an enhanced deduction for contributions of food inventory. The enhanced deduction is available only for food that qualifies as **apparently wholesome food,** which is defined as food intended for human consumption that meets all quality and labeling standards imposed by federal, state and local laws, and regulations.[123]

For charitable contributions of food inventory made during 2020 that qualify for an enhanced deduction, the 15% limitation that applied under the TCJA is increased to 25%.[124]

The code section reads:

> *If a taxpayer- (I) does not account for inventories under section 471, and (II) is not required to capitalize indirect costs under section 263A, the taxpayer may elect, solely for purposes of subparagraph (B),* ***to treat the basis of any apparently wholesome food as being equal to 25 percent of the fair market value of such food****.* [emphasis added]

The reference to subparagraph B above is to IRC §170(e)(3)(B), regarding the amount of reduction for any qualified contribution.

CAA

NEW LAW[125]

The CAA extends the increased charitable contribution limitations that applied under the CARES Act to the 2021 tax year. Therefore, the following provisions apply to both the 2020 and 2021 tax years.

- An individual taxpayer can deduct qualified cash contributions up to the amount by which **100%** of the taxpayer's contribution base exceeds the deduction for other charitable contributions.
- For C corporations, the deduction for qualified contributions is allowed up to **25%** of the corporation's taxable income.
- For charitable contributions of food inventory, the **25%** limit, discussed previously, applies.

123. IRC §170(e)(3)(C)(i).

124. IRC §170(e)(3)(C)(iv).

125. *Consolidated Appropriations Act of 2021,* PL 116-260, §213, Div. EE.

FULL DEDUCTION FOR BUSINESS MEALS

OLD LAW[126]

Meals provided by an employer to employees and their spouses and dependents for the employer's convenience and on the employer's business premises are 50% deductible by the employer. The entire value of the meals is excludable from the employee's income. Effective January 1, 2018, the 50% limitation also applies to meals that are considered a de minimis fringe benefit.[127] The term **de minimis fringe** is defined as the value of any property or service that is so small as to make accounting for it unreasonable or impracticable.[128]

To qualify for the 50% business meals deduction, the following requirements must be satisfied.[129]

- The expense is not lavish or extravagant under the circumstances.
- The taxpayer, or an employee of the taxpayer, is present at the furnishing of such food or beverages.
- The food or beverages are provided to the taxpayer or a business associate.

CAA

NEW LAW[130]

Under the CAA, expenses for food and beverages provided by a restaurant that are paid or incurred after December 31, 2020, and before January 1, 2023, are fully deductible. Therefore, 100% of business meals **purchased from restaurants** in 2021 and 2022 are deductible.

> **Note.** The IRS provided guidance as to the definition of a restaurant in IRS Notice 2021-25.[131] The definition provided in the notice is:
>
> *. . . For this purpose, the term "restaurant" means a business that prepares and sells food or beverages to retail customers for immediate consumption, **regardless of whether the food or beverages are consumed on the business's premises**. However, a restaurant does not include a business that primarily sells pre-packaged food or beverages not for immediate consumption, such as a grocery store; specialty food store; beer, wine, or liquor store; drug store; convenience store; newsstand; or a vending machine or kiosk.* [emphasis added]

126. IRC §§162(a) and 274; *Tax Cuts and Jobs Act,* PL 115-97, §13304.
127. IRC §274(n).
128. IRC §132(e).
129. Treas. Reg. §1.274-12.
130. *Consolidated Appropriations Act of 2021,* PL 116-260, §210, Div. EE; IRC §274(n)(2)(D).
131. IRS Notice 2021-25, 2021-17 IRB 1118.

TEMPORARY RULES FOR FSAs[132]

OLD LAW

A cafeteria plan is a written employer-sponsored benefits package offering employees a choice between two or more benefits consisting of either cash or qualified benefits that may be excluded from income.[133] Medical expense reimbursement plans such as a health savings account (HSA) or FSA are commonly offered as part of a cafeteria plan.[134] Dependent care assistance can be paid or reimbursed under a dependent care FSA offered through a cafeteria plan.[135]

A cafeteria plan can permit the carryover of unused amounts remaining in a health FSA at the end of a plan year to pay or reimburse a participant for medical expenses incurred during the following plan year, subject to the **carryover limit.** The maximum unused amount that can be carried over from a plan year starting in 2020 to the plan year beginning in 2021 is $550.[136]

Alternatively, a cafeteria plan can allow a participant to apply unused amounts at the end of the plan year to pay expenses incurred for qualified benefits during a period up to two months and 15 days following the end of the plan year **(grace period).**

A cafeteria plan can adopt a carryover or grace period with respect to a health FSA, but it cannot adopt both features.

CAA

NEW LAW

The CAA provides temporary special rules for health FSAs and dependent care FSAs that are part of cafeteria plans. Specifically, the CAA provisions include the following.

- Flexibility for **carryovers of unused amounts** from the 2020 and 2021 plan years
- **Extension of the permissible period** for incurring claims for plan years ending in 2020 and 2021
- A special rule regarding **post-termination reimbursements** from health FSAs during plan years 2020 and 2021
- Special **age-limit relief** applicable to carryovers for dependent care FSAs
- Certain **mid-year election changes** for health FSAs and dependent care FSAs for plan years ending in 2021

Carryovers of Unused Amounts

An FSA can allow participants to carry over unused benefits remaining in a health FSA or dependent care FSA from a plan year ending in 2020 to a plan year ending in 2021 and from a plan year ending in 2021 to a plan year ending in 2022. Therefore, an employer can amend its cafeteria plan to provide a carryover of all or part of the unused amounts remaining in a health FSA or dependent care FSA at the end of a plan year ending in 2020 or 2021 to the immediately subsequent plan year.

Example 12. Longway Luggage Company sponsored a cafeteria plan in 2020. The cafeteria plan's health FSA provides for a $550 carryover to the following year. Longway can **amend the cafeteria plan** to allow employees to carry over the entire unused amount remaining in their health FSA as of December 31, 2020, to the 2021 plan year. The amount carried over can exceed $550.

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132. Ibid; *Consolidated Appropriations Act of 2021,* PL 116-260, §214, Div. EE.

133. IRC §125(d) and Prop. Treas. Reg. §1.125-1.

134. See Prop. Treas. Reg. §1.125-1.

135. See IRC §129.

136. IRS Notice 2020-33, 2020-22 IRB 868.

The CAA carryover provision is available to cafeteria plans that currently have a grace period or provide for a carryover, as well as plans that do not currently have such features. The employer can limit the carryover to an amount less than all unused amounts. The employer can also limit the carryover to apply only up to a specific date during the plan year.

Extension of the Permissible Period for Incurring Claims

The CAA provides flexibility for a cafeteria plan to allow an extended period to apply unused amounts that remain in a health FSA or dependent care FSA to pay or reimburse medical care expenses or dependent care expenses, respectively. An employer can amend one or more of its cafeteria plans to allow employees to apply unused amounts remaining in a health FSA or dependent care FSA at the end of a plan year ending in 2020 or 2021 to reimburse expenses incurred up to 12 months after the end of the plan year.

> **Example 13.** In 2020, Lilac Mattress Company sponsored a cafeteria plan with a health FSA. Lilac can amend the plan to allow employees to apply the unused amount remaining in their health FSA account as of December 31, 2020, to reimburse the employees for medical care they incur through December 31, 2021.

An employer can choose to adopt an extended period for incurring claims that is less than 12 months. In addition, an employer can choose to adopt a period that ends before the end of the plan year during which employees who have terminated participation in a plan can continue to receive reimbursements. This feature is available to cafeteria plans that currently have a grace period or provide for a carryover, as well as plans that do not currently have a grace period or provide for a carryover.

> **Example 14.** Live Oak Fitness Company sponsored a cafeteria plan with a health FSA having a plan year that ends every September 30. Live Oak's FSA contains no provision for a grace period or a carryover. Bernie is a long-time employee who terminated his employment with Live Oak on January 15, 2021. Under terms of the FSA Bernie was required to submit a request for reimbursement of medical expenses by that date. However, Live Oak's management is aware that many employees have deferred medical expenses because of reduced income, and elects to extend the period for terminated employees to submit claims to September 30, 2021. Consequently, Bernie has until September 30, 2021, to submit claims for reimbursement of his medical expenses.

Post-Termination Reimbursements

An employee who terminates participation in a cafeteria plan during the 2020 or 2021 calendar year can continue to receive reimbursements from unused benefits through the end of the plan year in which participation terminated (including any grace period).

Age-Limit Relief

Generally, expenses that can be reimbursed from a dependent care FSA must be for a dependent who has not attained **age 13** or a dependent who is physically or mentally incapable of caring for themself and who lives with the taxpayer for more than half of the year.[137] The CAA provides that, for certain employees, expenses that can be paid or reimbursed from a dependent care FSA can be used for a dependent who has not reached **age 14.** This applies to expenses paid or reimbursed during:

- The last plan year for which the end of the regular enrollment period was on or before January 31, 2020; and
- For an employee who has an unused balance in a dependent care FSA for the plan year, the subsequent plan year.

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137. See IRC §§21(b) and 129.

This relief only applies to certain eligible employees. For this purpose, an **eligible employee** is defined as an employee who:

- Is enrolled in a dependent care FSA for the last plan year for which the end of the regular enrollment period was on or before January 31, 2020; **and**
- Has at least one dependent who attained the age of 13 either:
  - During the plan year; **or**
  - For an employee who has unused dependent care amounts for that plan year, during the subsequent plan year.

An employer may amend one or more of its cafeteria plans to adopt the special age-limit relief. An employer that adopts the age-limit relief is not required to adopt the carryover provision or an extended period for incurring claims that are available under the CAA.

> **Example 15.** Filips Tax Service provides a dependent care FSA. The regular enrollment period for the 2020 plan year (March 1, 2020, through February 28, 2021) ended on January 31, 2020. Keri, who is an eligible employee of Filips Tax Service, elected to enroll in the dependent care FSA for the 2020 plan year and elected to contribute $2,000.
>
> Keri's dependent, Collin, turned 13 on February 1, 2021. As of January 31, 2021, Keri had incurred no qualifying expenses for the 2020 plan year. However, she anticipates incurring dependent care expenses during the summer of 2021, which is during the 2021 plan year.
>
> Filips amends its cafeteria plan by substituting "under age 14" for "under age 13" for the 2020 and 2021 plan years. Filips allows employees to incur claims until the end of the subsequent plan year. Keri incurs $2,200 in dependent care expenses from June through August 2021 for Collin, who is age 13 at the time. For the 2021 plan year (March 1, 2021, through February 28, 2022), $2,000 of the $2,200 in dependent care expenses can be reimbursed by the dependent care FSA.

Mid-Year Election Changes

The CAA provides that cafeteria plans can allow employees to make prospective mid-year election changes for health FSAs and dependent care FSAs for plan years ending in 2021. The allowable mid-year election changes include the following.

- The plan can allow an employee to elect to modify prospectively the amount of the employee's contributions to the arrangement (but not in excess of any applicable dollar limit). Such changes are allowable without regard to any change in the employee's status.
- The employer can amend a cafeteria plan to allow employees to:
  - Make a new election for employer-sponsored health coverage on a prospective basis if the employee previously declined to elect employer-sponsored health coverage;
  - Revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis; or
  - Revoke an existing election for employer-sponsored health coverage prospectively, provided that the employee states in writing that the employee is enrolled (or will immediately enroll) in other health coverage not sponsored by the employer.

EXTENSION OF CERTAIN DEFERRED PAYROLL TAXES

OLD LAW[138]

On August 8, 2020, President Trump issued a presidential memorandum to the Secretary of the Treasury regarding the withholding, deposit, and payment of certain payroll taxes. The Secretary of the Treasury determined that employers are affected by the COVID-19 pandemic for purposes of the relief described in the memorandum. Consequently, the due date for affected taxpayers for the **withholding and payment** of the Federal Insurance Contributions Act (FICA) taxes imposed by IRC §3101(a) and the Railroad Retirement Tax Act (RRTA) tax imposed by IRC §3201 on applicable wages is postponed until the period beginning on January 1, 2021, and ending on April 30, 2021. The deferral applied to the 6.2% tax for the **employee's** portion of old age, survivors, and disability insurance (OASDI) and **employee** compensation taxed at 6.2% under the RRTA. This action is intended to "put money in the pockets of American workers and generate additional incentives for work and employment…"[139]

Applicable wages for this purpose are defined as wages or compensation paid to an employee during the period **beginning on September 1, 2020, and ending on December 31, 2020.** This applies only if the amount of wages or compensation paid for a biweekly pay period is less than the **threshold amount of $4,000** (or the equivalent amount paid with respect to other pay periods). The determination of applicable wages is made separately for each pay period. Accordingly, if the amount of wages or compensation payable to an employee for a certain pay period is less than the threshold amount, then the wages or compensation paid is considered applicable wages for the pay period. This determination is not affected by the amount of wages or compensation paid to the employee for other pay periods.

Under the terms of the memorandum, the employer must withhold and pay the deferred payroll taxes ratably from wages and compensation paid between **January 1, 2021, and April 30, 2021.** Interest, penalties, and additions to tax apply to any unpaid, applicable taxes beginning on **May 1, 2021.**

> **Note.** The presidential memorandum **allows** employers to defer withholding and payment of the employee's portion of the applicable taxes. Employers were not required to defer such taxes.[140]

CAA

NEW LAW[141]

Under the CAA, the repayment period is extended for the employee taxes that were deferred under the presidential memorandum. The taxes deferred on wages paid between September 1, 2020, and December 31, 2020, can be paid back ratably from wages and compensation paid during the period beginning January 1, 2021, and ending December 31, 2021. Interest, penalties, and additions to tax will apply to any unpaid applicable taxes beginning on January 1, 2022.

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138. IRS Notice 2020-65, 2020-38 IRB 567.

139. 85 Fed. Reg. 49,587 (Aug. 13, 2020).

140. IRS News Rel. 2020-195 (Aug. 28, 2020).

141. *Consolidated Appropriations Act of 2021,* PL 116-260, §274, Div. N.

EDUCATOR EXPENSE TAX DEDUCTION

OLD LAW

An eligible educator can deduct up to $250 of unreimbursed trade or business expenses as an "above-the line" adjustment to gross income. Qualified expenses for this purpose include amounts paid or incurred for participation in professional development courses, books, certain supplies, computer equipment, other equipment, and supplementary materials used in the classroom.[142]

IRC §62(d)(1)(A) defines an **eligible educator** as an individual who is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year.

CAA

NEW LAW[143]

The CAA provided that the Secretary of the Treasury must issue guidance to clarify that personal protective equipment, disinfectant, and other supplies (COVID-19 protective items) used for the prevention of the spread of COVID-19 are treated as qualified expenses as described in §62(a)(2)(D)(ii). To accomplish this purpose, the Treasury issued Rev. Proc. 2021-15, which provides a safe harbor for eligible educators to treat unreimbursed expenses paid or incurred after March 12, 2020, for COVID-19 protective items as qualified expenses eligible for the above-the-line deduction.

COVID-19 protective items include, but are not limited to, the following.

- Face masks
- Disinfectant for use against COVID-19
- Hand soap
- Hand sanitizer
- Disposable gloves
- Tape, paint, or chalk used to guide social distancing
- Physical barriers (e.g., clear plexiglass)
- Air purifiers
- Other items recommended by the Centers for Disease Control and Prevention (CDC) to be used for the prevention of the spread of COVID-19

142. IRC §62(a)(2)(D).

143. *Consolidated Appropriations Act of 2021,* PL 116-260, §275, Div. N; Rev. Proc. 2021-15, 2021-8 IRB 891.

MONEY PURCHASE PENSION PLANS

CARES

OLD LAW[144]

Section 2202 of the CARES Act allows an exception to the 10% early withdrawal tax for a coronavirus-related distribution of $100,000 or less from a qualified retirement plan, a 403(b) plan, or an IRA. A coronavirus-related distribution is defined as any distribution from a qualified retirement plan, 403(b) plan, governmental 457(b) plan, or an IRA made after December 31, 2019, and before December 31, 2020, to an individual:

- Who was diagnosed with the virus SARS-CoV-2 or with COVID-19 by a test approved by the CDC; or
- Whose spouse or dependent was diagnosed with the virus or disease by a CDC-approved test; or
- Who has experienced adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to such virus or disease, being unable to work due to lack of childcare due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease, or other factors as determined by the Secretary of the Treasury (or the Secretary's delegate).

A taxpayer includes the income attributable to a coronavirus-related distribution ratably over a 3-year period beginning with the year of the distribution. However, the taxpayer can elect to include the entire amount of the distribution in income in the year they receive it.

Any portion of a coronavirus-related distribution can be recontributed to an eligible retirement plan that can accept rollover contributions. The recontribution can be made at any time during the 3-year period beginning the day after the date on which the taxpayer received the distribution. Any amount recontributed within the 3-year period is treated as a rollover. Therefore, it is not includable in income. If a portion of the distribution has not yet been included in the taxpayer's income at the time of the recontribution, the remaining amount is not includable in income. In addition, the taxpayer can file amended returns to claim a refund of the tax attributable to the amount of the distribution previously included in income.

The CARES Act modifies the rules applicable to loans. For a qualified individual, a loan is not treated as a distribution if the maximum loan amount from a qualified employer plan during the 180-day period beginning on the date of enactment (i.e., from March 27, 2020, to September 23, 2020) is the lesser of 100% of the present value of the participant's nonforfeitable accrued account balance or $100,000.

For a qualified individual who has an outstanding loan from a qualified employer plan on or after March 27, 2020, the due date for any repayment is delayed by one year if the due date for the repayment falls during the period beginning on March 27, 2020, and ending on December 31, 2020. Any subsequent repayment dates are adjusted to reflect the 1-year delay. In addition, the repayment delay is disregarded for purposes of the requirement that a loan be repaid within five years.

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144. *CARES Act,* PL 116-136, §2202; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Feb. 25, 2021.

CAA

NEW LAW[145]

The CAA provides that coronavirus-related distributions can be made from money purchase pension plans under the same rules that apply to qualified retirement plans, 403(b) plans, and IRAs. Therefore, the 10% early withdrawal tax does not apply to such distributions. In addition, taxpayers can include the income related to the distribution in income ratably over a 3-year period. Alternatively, they can elect to include the entire amount of the distribution in income in the year they receive it.

Taxpayers can also recontribute a coronavirus-related distribution made from a money purchase pension plan at any time during the 3-year period beginning the day after the date on which the taxpayer received the distribution. Such recontributions are treated as a rollover and are, therefore, not includable in income.

Further, loans from money purchase pension plans qualify for the special rules under §2202 of the CARES Act. Therefore, the increased limits for loans apply, as does the delayed due date for such loans.

These provisions apply retroactively, as if included in the enactment of §2202 of the CARES Act.

> **Note.** To have these provisions apply to a money purchase pension plan (or any other qualified plan under §2202 of the CARES Act), nongovernmental plans must be amended by the last day of the first plan year beginning on or after January 1, 2022. Governmental plans must be amended by the last day of the first plan year beginning on or after January 1, 2024. The amendment must apply retroactively for such period.[146]

EXTENSION OF EBL LIMITATION

OLD LAW

TCJA

Under the TCJA, noncorporate taxpayers could not deduct excess business losses (EBLs) for tax years beginning after December 31, 2017, and before January 1, 2026. Instead, such losses are treated as part of the taxpayer's NOL **carryforward** to subsequent tax years.[147]

CARES

The CARES Act amended IRC §172(b)(1) to provide for a **carryback** of any NOL arising in a tax year beginning **after December 31, 2017, and before January 1, 2021,** to each of the five tax years preceding the tax year in which the loss arises. Thus, for tax years beginning after 2017 and before 2021, a 5-year carryback of NOLs is allowed for all taxpayers.

Under the CARES Act modifications, for **tax years beginning after 2020 and before 2026,** a taxpayer who files MFJ is limited to $500,000 of EBLs, and single taxpayers are limited to $250,000 of EBLs. These amounts are adjusted annually for inflation.[148] Excess losses can be carried forward indefinitely.[149]

In addition, NOLs can only offset 80% of taxable income for tax years beginning after 2020 and before 2026. The NOL deduction is limited to the lesser of:

- The aggregate of NOL carryforwards and carrybacks to the tax year, or
- 80% of taxable income calculated for the tax year without regard to the NOL deduction allowed for the tax year.[150]

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145. *Consolidated Appropriations Act of 2021,* PL 116-260, §280, Div. N.
146. *CARES Act,* PL 116-136, §2202(b)(2).
147. *Tax Cuts and Jobs Act,* PL 115-97, §11012; IRC §461(l).
148. IRC §461(l)(3)(C).
149. IRC §172(b)(1)(A).
150. IRC §172(a).

ARPA

NEW LAW[151]

The ARPA extends the EBL limitation provisions for one year. Therefore, an MFJ taxpayer is limited to an NOL deduction of $500,000 and single taxpayers are limited to an NOL deduction of $250,000 for tax years beginning after 2020 and **before 2027,** adjusted for inflation. For 2021, the inflation-adjusted amounts are $524,000 for MFJ taxpayers and $262,000 for single taxpayers.[152] In addition, NOLs can only offset 80% of taxable income for tax years beginning after 2020.[153] NOLs in excess of these amounts can be carried forward indefinitely.[154]

SUSPENSION OF TAX ON UNEMPLOYMENT COMPENSATION

OLD LAW[155]

Unemployment compensation is includable in gross income for federal income tax purposes under IRC §85. The term **unemployment compensation** applies to amounts paid under state or federal governmental programs and not to amounts paid under private nongovernmental unemployment compensation plans.

ARPA

NEW LAW[156]

Under the ARPA, unemployment compensation up to $10,200 is excluded from income for taxpayers with AGI less than $150,000. This applies only to unemployment compensation paid in **2020.** For married taxpayers, up to $10,200 in unemployment compensation received by **each spouse** is excludable from income. Amounts over $10,200 per individual are taxable.

Taxpayers whose AGI is more than $150,000 (not including unemployment benefits) cannot exclude any unemployment compensation. **The $150,000 AGI limit applies regardless of the taxpayer's filing status.** For this purpose, the taxpayer's AGI is determined after calculating the following.

- Taxable social security benefits under IRC §86
- Exclusion of income from U.S. savings bonds used to pay higher education tuition and fees under IRC §135
- Exclusion of employer-provided adoption benefits under IRC §137
- IRA deduction under IRC §219
- Student loan interest deduction under IRC §221
- Tuition and fees deduction under IRC §222
- Deduction of up to $25,000 for active participation in a passive rental real estate activity under IRC §469

The exclusion for nontaxable unemployment compensation should be **reported separately** from the taxpayer's unemployment compensation on Schedule 1, *Additional Income and Adjustments to Income.* Total unemployment compensation is reported on line 7 of Schedule 1, and the exclusion is reported on line 8.

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151. *American Rescue Plan Act,* PL 117-2, §9041.

152. Rev. Proc. 2020-45, 2020-46 IRB 1016.

153. IRC §172(a)(2).

154. IRC §172(b)(1)(A).

155. IRC §85; Treas. Reg. §1.85-1.

156. *American Rescue Plan Act,* PL 117-2, §9042; *New Exclusion of up to $10,200 of Unemployment Compensation.* Apr. 1, 2021. IRS. [www.irs.gov/forms-pubs/new-exclusion-of-up-to-10200-of-unemployment-compensation] Accessed on Apr. 26, 2021.

Note. For affected taxpayers who already filed their tax returns before the ARPA was enacted (i.e., March 11, 2021), the IRS announced it would determine the correct taxable amount of unemployment compensation. Any resulting overpayment of tax will either be refunded or applied to other outstanding tax liabilities. Taxpayers do not need to file an amended return unless the nontaxability of unemployment compensation makes them eligible for additional federal credits and deductions that they did not include on their original tax return.[157]

Practitioner Planning Tip

Practitioners are advised to review the calculations made automatically by the IRS related to nontaxable unemployment. Particular attention should be paid to credits and deductions not included on the original return because of AGI limitations (e.g., EIC). Additionally, practitioners may wish to update the returns in their software so that calculations in future years reflect the final 2020 amounts.

Practitioner Planning Tip

Some states tax unemployment compensation and others do not. Some states that normally tax unemployment compensation, such as Illinois, announced that they adopted the ARPA provision making the first $10,200 of unemployment benefits nontaxable for individuals with federal AGI that did not exceed $150,000.[158] Tax professionals with clients who file tax returns in other states should consult the laws of those states to determine the taxability of unemployment compensation in each respective state.

157. IRS News Rel. 2021-71 (Mar. 31, 2021).

158. *American Rescue Plan Act of 2021 – Nontaxable Unemployment Benefits.* Mar. 30, 2021. Illinois Department of Revenue. [www2.illinois.gov/rev/Pages/American-Rescue-Plan-Act-of-2021---Nontaxable-Unemployment-Benefits.aspx] Accessed on Apr. 26, 2021.

CLARIFICATION OF TAX TREATMENT OF EIDL LOAN FORGIVENESS

CARES

OLD LAW

The PPP is one of two programs created by the government to aid small businesses during the pandemic. The second is the Economic Injury Disaster Loan (EIDL) program. While both programs were designed to help companies continue operating through the pandemic, each program is slightly different.

The PPP was implemented to help small businesses retain workers (or continue payroll) by covering eight weeks (24 weeks under the PPPFA) of payroll plus other operational costs, as discussed earlier. These loans can be forgiven entirely if program guidelines are followed. Lenders (banks, credit unions, etc.) provided the funding for the PPP with loans guaranteed by the SBA. The EIDL program is a direct SBA program designed to provide economic relief to small businesses that are experiencing a temporary loss of revenue due to COVID-19. EIDL program provisions include a maximum $10,000 advance that is automatically forgiven.[159]

CAA

NEW LAW[160]

Similar to the treatment of PPP loans, the CAA clarifies that any EIDL advance described in §1110(e) of the CARES Act or any funding under §331 of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act **should not be included in the gross income** of the recipient of the advance or funding. In addition, the CAA provides that no deduction of business expenses are disallowed because the advance or funding was excluded from the recipient's gross income. The CAA further provides that **no tax attribute should be reduced and no basis increase should be denied** because of the forgiven advance or funding, as is required under §108 for certain other forgiven debts.

Amounts forgiven under the EIDL program for partnerships and S corporations are treated as tax-exempt income when determining a partner's basis under §705 or the pass-through of items to an S corporation shareholder under §1366.

These provisions apply to tax years ending after March 27, 2020.

TAX TREATMENT OF TARGETED EIDL ADVANCES

CARES

OLD LAW

As mentioned earlier, the EIDL program is designed to provide economic relief to small businesses that are experiencing a temporary loss of revenue due to COVID-19. The EIDL program provides a maximum $10,000 advance that is automatically forgiven.[161]

The CAA clarified that certain EIDL advances should not be included in the gross income of the recipient. In addition, no deduction of business expenses will be disallowed, no tax attribute should be reduced, and no basis increase should be denied because the advance or funding was excluded from the recipient's gross income.[162]

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159. *Frequently Asked Questions, COVID-19 Economic Injury Disaster Loan (EIDL).* Feb. 4, 2021. SBA. [www.sba.gov/sites/default/files/2021-02/COVID-19%20EIDL%20FAQs_02.04.21-508.pdf] Accessed on Aug. 10, 2021.

160. *Consolidated Appropriations Act of 2021,* PL 116-260, §278, Div. N.

161. *Frequently Asked Questions, COVID-19 Economic Injury Disaster Loan (EIDL).* SBA. [www.sba.gov/sites/default/files/2021-02/COVID-19%20EIDL%20FAQs_02.04.21-508.pdf] Accessed on Aug. 10, 2021.

162. *Consolidated Appropriations Act of 2021,* PL 116-260, §278, Div. N.

ARPA

NEW LAW[163]

Targeted EIDL advances provide businesses in low-income communities with additional funds to ensure continuity of the business, adaptation, and resiliency.[164] The ARPA provides an additional $15 billion in funding for targeted EIDL payments. This includes $5 billion in new funding for supplemental targeted EIDL advance payments of $5,000 for entities that meet the following conditions.[165]

- Is located in a low-income community
- Suffered an economic loss of greater than 50% during an 8-week period beginning on or after March 2, 2020, compared to the same period of the previous year
- Employs no more than 10 employees

The supplemental targeted $5,000 advance payments do not have to be repaid.[166]

As was the case for EIDL advances under the CAA, the ARPA provides that any targeted EIDL advance described in §331 of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (title III of division N of the CAA) should not be included in the gross income of the recipient of the advance. In addition, the ARPA provides that no deduction of business expenses will be disallowed, no tax attribute should be reduced, and no basis increase should be denied because of the exclusion from gross income.

Amounts forgiven under the targeted EIDL program for partnerships and S corporations are treated as tax-exempt income when determining a partner's basis under IRC §705 or the pass-through of items to an S corporation shareholder under IRC §1366.

TAX TREATMENT OF RESTAURANT REVITALIZATION GRANTS

OLD LAW

Under IRC §61, gross income includes income from whatever source derived, unless excluded by law. As discussed earlier, exceptions are provided for PPP loans forgiven and EIDL advances, which may be excluded from the recipient's gross income.

ARPA

NEW LAW[167]

The ARPA established the restaurant revitalization fund to provide grants to help restaurants and other eligible businesses continue operating. The program provides restaurants with funding for their COVID-19 related revenue losses of up to $10 million per business and up to $5 million per location. The minimum funding amount is $1,000. Recipients are not required to repay the amounts they receive if the funds are used for eligible purposes by March 11, 2023.

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163. *American Rescue Plan Act,* PL 117-2, §§5002 and 9672.

164. *COVID-19 Economic Injury Disaster Loan.* SBA. [www.sba.gov/funding-programs/loans/covid-19-relief-options/covid-19-economic-injury-disaster-loan#section-header-3] Accessed on Aug. 10, 2021.

165. *American Rescue Plan Act Elevates Small Business Support in Response to COVID-19 Pandemic.* Mar. 11, 2021. SBA. [www.sba.gov/article/2021/mar/11/american-rescue-plan-act-elevates-small-business-support-response-covid-19-pandemic] Accessed on Aug. 10, 2021; *COVID-19 Economic Injury Disaster Loan.* SBA. [www.sba.gov/funding-programs/loans/covid-19-relief-options/covid-19-economic-injury-disaster-loan#section-header-3] Accessed on Aug. 10, 2021.

166. *COVID-19 Economic Injury Disaster Loan.* SBA. [www.sba.gov/funding-programs/loans/covid-19-relief-options/covid-19-economic-injury-disaster-loan#section-header-3] Accessed on Aug. 10, 2021.

167. *American Rescue Plan Act,* PL 117-2, §9673; *Restaurant Revitalization Fund.* SBA. [www.sba.gov/funding-programs/loans/covid-19-relief-options/restaurant-revitalization-fund#section-header-2] Accessed on May 4, 2020.

The following types of entities that have experienced revenue losses related to COVID-19 can apply for the grants.

- Restaurants
- Food stands, food trucks, and food carts
- Caterers
- Bars, saloons, lounges, and taverns
- Snack and nonalcoholic beverage bars
- Bakeries (if onsite sales to the public comprise at least 33% of gross receipts)
- Brewpubs, tasting rooms, taprooms (if onsite sales to the public comprise at least 33% of gross receipts)
- Breweries and microbreweries (if onsite sales to the public comprise at least 33% of gross receipts)
- Wineries and distilleries (if onsite sales to the public comprise at least 33% of gross receipts)
- Inns (if onsite sales of food and beverage to the public comprise at least 33% of gross receipts)
- Licensed facilities or premises of a beverage alcohol producer where the public can taste, sample, or purchase products

Funds can be used for the following eligible purposes.

- Payroll costs (including sick leave)
- Payments on business mortgage obligations
- Rent payments (not including prepayment of rent)
- Debt service (including principal and interest but not including any prepayment of principal or interest)
- Utility payments
- Maintenance expenses
- Construction of outdoor seating
- Supplies (including protective equipment and cleaning materials)
- Food and beverage expenses
- Supplier costs
- Operating expenses

The recipients of restaurant revitalization grants are subject to the same tax treatment as the recipients of EIDL advances. Specifically, the ARPA provides that the amount of any restaurant revitalization grant is **not included in the gross income** of the recipient. In addition, the ARPA provides that no deduction of business expenses will be disallowed, no tax attribute should be reduced, and no basis increase should be denied because of the exclusion from gross income.

Amounts received as restaurant revitalization grants by partnerships and S corporations are treated as tax-exempt income when determining a partner's basis under §705 or the pass-through of items to an S corporation shareholder under §1366.

> **Note.** After an "overwhelming response" to the restaurant revitalization grant program, the SBA's application portal closed for new applications on May 24, 2021.[168]

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[168] *Welcome to the Restaurant Revitalization Award Portal.* SBA. [restaurants.sba.gov/requests/borrower/login/?next=/] Accessed on May 26, 2021; *Last Call: Administrator Guzman Announces Final Push for Restaurant Revitalization Fund Applications.* May 18, 2021. SBA. [www.sba.gov/article/2021/may/18/last-call-administrator-guzman-announces-final-push-restaurant-revitalization-fund-applications] Accessed on Aug. 10, 2021.

APPLICATION OF CERTAIN MODIFICATIONS TO FARMING LOSSES

CARES

OLD LAW

The CARES Act made changes to the NOL and EBL rules that were enacted as part of the TCJA. The CARES Act amended §172(b)(1) to provide for a carryback of any NOL arising in a tax year beginning after December 31, 2017, and before January 1, 2021, to each of the five tax years preceding the tax year in which the loss arises. Thus, for tax years beginning after 2017 and before 2021, a 5-year carryback of NOLs is allowed for all taxpayers, farm and nonfarm.

Before the TCJA, (i.e., before 2018), a farming NOL could be carried back five years, or, by making an irrevocable election, a farmer could forgo the 5-year carryback period and carry the loss back two years (or three years for a loss attributable to a federally declared disaster).[169] Under the CARES Act, the 2-year NOL carryback is no longer available for farmers for 2018 through 2020. For NOLs arising in 2018–2020, the general carryback is to each of the five tax years preceding the tax year in which the loss arises.

In addition, the CARES Act made changes to the EBL rules enacted by the TCJA. Under the TCJA rules, for tax years beginning after 2017 and before 2026, a taxpayer who filed MFJ was limited to carrying back up to $500,000 of EBLs. Single taxpayers were limited to carrying back $250,000 of EBLs. EBLs exceeding the threshold amount must be carried forward as part of the NOL carryover to the following year.

TCJA

Moreover, under the TCJA, for tax years beginning after December 31, 2017, NOLs could only offset 80% of taxable income (the former rule allowed a 100% offset). The NOL deduction was limited to the lesser of:

- The aggregate of NOL carryforwards and carrybacks to the tax year, or
- 80% of taxable income computed for the tax year without regard to the NOL deduction allowed for the tax year.[170]

The CARES Act eliminated the EBL limitation of $250,000 (single) and $500,000 (MFJ) for tax years 2018–2020. The CARES Act also delayed the 80% EBL limitation until 2021. For tax years beginning after December 31, 2020, a taxpayer is eligible for a full NOL deduction attributable to tax years before 2018, and 80% of modified taxable income for NOLs arising in tax years after 2017.[171]

Note. The elimination of EBLs under the CARES Act for tax years 2018–2020 means that a taxpayer may deduct business losses without limit for 2018–2020 and carry the losses back five years.

Note. For more information about the rules that applied to farming losses under the TCJA and the CARES Act, see the 2020 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 5: Agricultural Issues and Rural Investments. Also see the 2021 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 5: Agricultural Issues and Rural Investments.

169. IRC §§172(b)(1)(E) and (F) prior to being stricken by *Tax Cuts and Jobs Act,* PL 115-97, §13302.

170. IRC §172(a).

171. *CARES Act,* PL 116-136, §2303(b).

CAA

NEW LAW[172]

The CAA provides special rules for farming losses. Under these rules, taxpayers with farming losses (as defined in §172(b)(1)(B)(ii)) for any tax year beginning in 2018, 2019, or 2020 can make an **irrevocable** election:

- To apply the 80% EBL taxable income limits to any tax year beginning in 2018, 2019, or 2020; and
- To apply the 2-year carryback period (rather than the 5-year carryback) to any NOL arising in a tax year beginning in 2018, 2019, or 2020.

If a farming taxpayer makes this election, the 80% taxable income limit applies, and the 2-year carryback period applies for the tax year for which the election is made.

The election must be made by the due date (including extensions) for filing the taxpayer's return for the first tax year ending after December 27, 2020. For taxpayers who filed a 2018, 2019, or 2020 return before December 27, 2020, in which they applied the 80% EBL limitation and the 2-year carryback period, the taxpayer is treated as having made the election provided by the CAA. If the taxpayer wants to revoke the deemed election (i.e., the taxpayer does not want the 80% EBL limitation and the 2-year carryback period to apply to a previously filed return), they can amend the return to reflect the amendments provided by the CAA. The amended return must be filed by the due date for filing the taxpayer's return for the first tax year ending after December 27, 2020.

DISASTER-RELATED TAX RELIEF

CAA

OVERVIEW[173]

The CAA contains the following provisions relating to disaster tax relief.

- Penalty on disaster-related distributions from retirement funds
- Disaster-related loans from retirement funds
- Employee retention credit for employers affected by qualified disasters
- Other disaster-related tax relief provisions

For purposes of the disaster relief contained in the CAA, the term **qualified disaster area** is defined as any area in which a major disaster was declared by the president during the period **between January 1, 2020, and February 25, 2021** (60 days after the enactment of the CAA). However, a qualified disaster area does **not** include any area to which a major disaster has been declared **only** because of COVID-19.

The term **incident period** means the period specified by the Federal Emergency Management Agency as the period during which the disaster occurred. For purposes of the CAA, this period begins on or after December 28, 2019, and on or before December 27, 2020 (date of enactment of the CAA).

PENALTY ON DISASTER-RELATED DISTRIBUTIONS FROM RETIREMENT FUNDS

Old Law

A distribution from an eligible retirement plan is generally included in income. Unless an exception applies, a distribution from a qualified retirement plan, a 403(b) plan, or an IRA that the taxpayer receives before turning age 59½ is subject to a 10% early withdrawal tax on the amount includable in income.[174]

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172. *Consolidated Appropriations Act of 2021,* PL 116-260, §281, Div. N.

173. *Consolidated Appropriations Act of 2021,* PL 116-260, §301, Div. EE.

174. IRC §72(t); *Topic No. 558 Additional Tax on Early Distributions from Retirement Plans Other than IRAs.* Mar. 8, 2021. IRS. [www.irs.gov/taxtopics/tc558] Accessed on Mar. 11, 2021.

CAA

New Law

Under the CAA, the 10% early withdrawal tax does not apply to any qualified disaster distribution of up to $100,000. The $100,000 limit is reduced by the aggregate amounts the taxpayer treated as qualified disaster distributions for all prior tax years. The early withdrawal tax may apply to any distributions the taxpayer received in excess of $100,000. A **qualified disaster distribution** is defined as any distribution from an eligible retirement plan made:

- On or after the first day of the incident period of a qualified disaster and before June 25, 2021 (180 days after the enactment of the CAA), and
- To an individual whose main home at any time during the incident period of the qualified disaster is located in the qualified disaster area and who sustained an economic loss because of the disaster.

An **eligible retirement plan** for this purpose is defined as one of the following.

- An individual retirement account described in IRC §408(a)
- An individual retirement annuity described in §408(b)
- A qualified pension, profit-sharing, or stock bonus plan described in IRC §401(a)
- An annuity plan described in IRC §403(a)
- A 457(b) deferred compensation plan
- A 403(b) annuity plan

A taxpayer can generally repay any portion of a qualified disaster distribution that is eligible for tax-free rollover treatment to an eligible retirement plan. The taxpayer has three years from the day after the date they received the distribution to make a repayment. Amounts that are repaid are treated as a trustee-to-trustee transfer and are not included in income.

Qualified disaster distributions are generally included in the taxpayer's income in equal amounts over three years. However, the taxpayer can make an election to include the entire distribution in their income in the year they receive it.

Qualified Distribution for Purchase of Main Home.[175] A taxpayer who received a qualified distribution for the purchase or construction of a main home in a qualified disaster area can repay the distribution. A **qualified distribution** for this purpose is one that meets all the following requirements.

1. The disaster was a qualified disaster other than COVID-19.
2. The distribution is a hardship distribution from a 401(k) plan, a hardship distribution from a tax-sheltered annuity contract (403(b) plan), or a qualified first-time homebuyer distribution from an IRA.
3. The distribution was received no earlier than 180 days before the first day of the incident period for the disaster and no later than 30 days after the last day of the incident period for the disaster.
4. The distribution was to be used to purchase or construct a main home in the qualified disaster area and the main home was not purchased or constructed because of the disaster.

A taxpayer who received a qualified distribution for the purchase or construction of a main home can choose to repay the distribution to an eligible retirement plan on or after the first day of the disaster and no later than June 25, 2021. An **eligible retirement plan** for this purpose is any plan, annuity, or IRA to which a rollover can be made. Amounts that are repaid by June 25, 2021, are treated as a trustee-to-trustee transfer and are not included in the taxpayer's income.

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175. *Consolidated Appropriations Act of 2021,* PL 116-260, §302(b), Div. EE; Instructions for Form 8915-E.

DISASTER-RELATED LOANS FROM RETIREMENT FUNDS

Old Law

Employees can take loans from their qualified employer retirement plans without the loans being treated as distributions if certain requirements are met. Generally, the loan cannot exceed the lesser of:[176]

- The greater of $10,000 or 50% of the vested account balance, or
- $50,000.

CARES The CARES Act increased the limit on the allowable loan amount effective for loans made during the period March 27, 2020, through September 23, 2020. Under the CARES Act, the loan cannot exceed the lesser of:

- The greater of $10,000 or 100% of the vested account balance, or
- $100,000.[177]

CAA

New Law

Under the CAA, loans from a qualified employer plan cannot exceed the lesser of:

- $100,000, or
- The greater of $10,000 or 100% of the vested account balance.

The increased limits apply to loans made during the period beginning on December 27, 2020, and ending on June 25, 2021.[178]

ERC FOR EMPLOYERS AFFECTED BY QUALIFIED DISASTERS

FCAA

Old Law[179]

Eligible employers can claim a **2018 through 2019** qualified disaster ERC equal to 40% of the qualified wages paid to each eligible employee during the tax year. The amount of qualified wages that can be taken into account for any employee for the tax year cannot exceed $6,000 (reduced by the amount of qualified wages taken into account for the employee for any prior tax year).

The term **eligible employer** is any employer:

- That conducted an active trade or business in a qualified disaster zone at any time during the incident period of the qualified disaster; and
- The trade or business was inoperable at any time beginning on the first day of the incident period of the qualified disaster and ending on December 20, 2019, as a result ofdamage from the qualified disaster.

An **eligible employee** is an employee whose principal place of employment with the eligible employer (determined immediately before the qualified disaster) was in the qualified disaster zone.

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176. *Retirement Plans FAQs regarding Loans.* Sep. 4, 2020. IRS. [www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-loans] Accessed on Mar. 12, 2021.

177. *CARES Act,* PL 116-136, §2202(b).

178. *Consolidated Appropriations Act of 2021,* PL 116-260, §302(c), Div. EE.

179. *Further Consolidated Appropriations Act of 2020,* PL 116-94, Title II, §203.

Qualified wages are defined as wages paid or incurred by an eligible employer with respect to an eligible employee at any time on or after the date the trade or business first became inoperable at the principal place of employment, and ending on the earlier of:

- The date on which the trade or business resumes significant operations, or
- The date that is 150 days after the last day of the incident period of the qualified disaster.

CAA

New Law[180]

Eligible employers can claim a **2020** qualified disaster ERC equal to 40% of the qualified wages paid to each eligible employee for the tax year. The qualified wages that can be taken into account for any employee cannot exceed $6,000, reduced by the amount of qualified wages taken into account for that employee for any prior tax year.

The term **eligible employer** is any employer:

- That conducted an active trade or business in a qualified disaster zone at any time during the incident period of the qualified disaster; and
- The trade or business was inoperable at any time beginning on the first day of the incident period of the qualified disaster and ending on December 27, 2020, as a result of damage from the qualified disaster.

QUALIFIED DISASTER RELIEF CONTRIBUTIONS MADE BY CORPORATIONS

CARES

Old Law[181]

Under the CARES Act, a corporation can deduct qualified contributions up to 25% of the corporation's taxable income. Contributions in excess of this amount are carried forward to subsequent tax years.

Qualified contributions are cash contributions paid during 2020 to a charitable organization described in §170(b)(1)(A). Contributions for purposes of this provision cannot be made to a supporting organization described in §509(a)(3) or to a donor-advised fund. Contributions of noncash property are not qualified contributions. A qualified charitable contribution does not include an amount that is treated as a contribution in the tax year because it was carried forward from a prior contribution year under §§170(b)(1)(G) or (d)(1).

CAA

New Law[182]

For qualified disaster relief contributions made by a corporation, the 25% percentage limitation that applied under the CARES Act is increased to 100% of a corporation's taxable income.

A **qualified disaster relief contribution** is defined as any qualified contribution (defined previously) made during the period beginning on January 1, 2020, and ending on February 25, 2021, that is made for relief efforts in a qualified disaster area. The taxpayer must obtain contemporaneous written acknowledgement that the contribution is to be used for such relief efforts.

> **Note.** Because of the timing of the new law, the IRS recognizes that some corporations may have obtained a contemporaneous written acknowledgement that lacks a statement that it is to be used for disaster relief efforts. The IRS has stated that it will not challenge a corporation's deduction of any qualified contribution made before February 1, 2021, solely because the written acknowledgement does not contain the disaster relief statement.

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180. *Consolidated Appropriations Act of 2021,* PL 116-260, §303, Div. EE.

181. *CARES Act*, PL 116-136, §2205; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Mar. 15, 2021.

182. *Consolidated Appropriations Act of 2021,* PL 116-260, §304(a), Div. EE; IRS News Rel. 2021-27 (Jan. 29, 2021).

The corporation must elect to apply the increased limit applicable to qualified disaster relief contributions on its tax return. A corporation makes the election by calculating its deductible amount of qualified contributions using the increased limit and by claiming the appropriate amount on its return for the tax year in which the contribution was made.

QUALIFIED DISASTER-RELATED PERSONAL CASUALTY LOSSES

Old Law[183]

FCAA

Qualified disaster-related personal casualty losses are deductible regardless of whether the aggregate net losses exceed 10% of the taxpayer's AGI. To be deductible, the losses must exceed $500 per casualty.[184] Under the FCAA, a **qualified disaster-related personal casualty loss** includes an individual's casualty and theft of personal-use property that is attributable to a major disaster that was declared by the president before February 19, 2020. The incident period for the disaster must have occurred during the period beginning January 1, 2018, and before December 21, 2019. A **net disaster loss** is defined as the excess of qualified disaster-related personal casualty losses over personal casualty gains.

An individual who incurred a net disaster loss and does not itemize deductions can increase their standard deduction by the amount of the net disaster loss. The increase in the standard deduction amount is also allowed as a deduction for purposes of calculating alternative minimum taxable income (AMTI).

CAA

New Law[185]

Under the CAA, the definition of a **qualified disaster-related personal casualty loss** is expanded to include an individual's loss from a casualty or theft of personal-use property that is attributable to a major disaster that was declared by the president before February 26, 2021, and that occurred on or before December 27, 2020, and continued no later than January 26, 2021. As previously mentioned, this does not include losses attributable to a major disaster that was declared only by reason of COVID-19.[186]

As was the case before the enactment of the CAA, taxpayers can deduct qualified disaster-related personal casualty losses regardless of whether the aggregate net losses exceed 10% of the taxpayer's AGI. To be deductible, the losses must exceed $500 per casualty. An individual who incurred a net disaster loss and does not itemize deductions can increase their standard deduction by the amount of the net disaster loss. The increase in the standard deduction amount is also allowed as a deduction for purposes of calculating AMTI.

183. *Bipartisan Budget Act of 2018,* PL 115-123, §20104(b).

184. IRS Pub. 976, *Disaster Relief.*

185. *Consolidated Appropriations Act of 2021,* PL 116-260, §304(b), Div. EE.

186. Instructions for Form 4684.

EMERGENCY FINANCIAL AID GRANTS

CARES

OLD LAW[187]

The CARES Act provides that higher education institutions can use certain funds allocated by the Department of Education to support students and higher education institutions with expenses and financial needs related to COVID-19.

Section 3504 of the CARES Act allows higher education institutions to use additional supplemental educational opportunity grant funds they receive through the Higher Education Act to award emergency financial aid grants to graduate and undergraduate students who are experiencing "unexpected expenses and unmet financial need" as the result of COVID-19.

Section 18004 of the CARES Act further directs the Secretary of Education to allocate funds to higher education institutions to support students facing urgent needs related to the COVID-19 pandemic and to support institutions as they cope with the effects of the pandemic. These funds can be used:

1. To defray the institutions' expenses, including lost revenues and employee payroll; and
2. For "emergency financial aid grants to students for expenses related to the disruption of campus operations due to the COVID-19 pandemic (including eligible expenses under a student's cost of attendance, such as food, housing, course materials, technology, health care, and child care)."

CAA

NEW LAW[188]

The CAA provides that students who receive a qualified emergency financial aid grant:

1. Should not include the grant in their gross income, and
2. The grant should not be treated as a qualified scholarship, an educational assistance allowance, or other payment for purposes of the American opportunity credit or the lifetime learning credit. (Therefore, such grants do not reduce the taxpayer's qualified education expenses used to calculate the credit.[189])

The term **qualified emergency financial aid grant** is defined as:

- Any emergency financial aid grant awarded by an institution of higher education under §3504 of the CARES Act;
- Any emergency financial aid grant from an institution of higher education made with funds made available under §18004 of the CARES Act; and
- Any other emergency financial aid grant made to a student from a federal agency, a state, an Indian tribe, an institution of higher education, or a scholarship-granting organization for the purpose of providing financial relief to students enrolled at institutions of higher education in response to a qualifying emergency (as defined in §3502(a)(4) of the CARES Act).

The exclusion of a qualified emergency financial aid grant from the taxpayer's gross income does not apply to any amount that represents payment for teaching, research, or other services required as a condition for receiving the grant.

These provisions apply to qualified emergency financial aid grants made after March 26, 2020.

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187. *CARES Act,* PL 116-136, §§3504, 18004, and 18008; *FAQs: Higher Education Emergency Relief Fund and Emergency Financial Aid Grants under the CARES Act.* Dec. 14, 2020. IRS. [www.irs.gov/newsroom/faqs-higher-education-emergency-relief-fund-and-emergency-financial-aid-grants-under-the-cares-act#:~:text=Section%203504%20of%20the%20CARESunexpected%20expenses%20and%20unmet%20financial] Accessed on Feb. 23, 2021.

188. *Consolidated Appropriations Act of 2021.* PL 116-260, §276, Div. N.

189. See IRS Pub. 970, *Tax Benefits for Education.*

MINIMUM LOW-INCOME HOUSING TAX CREDIT RATE

OLD LAW[190]

Owners of residential low-income rental buildings can take a credit for each new low-income building placed in service after 1986. The credit is generally taken over a 10-year period.

The low-income housing credit can be claimed for residential rental buildings in low-income housing projects that meet one of the following requirements.

- **20-50 Test —** At least 20% of the residential units in the project must be both rent restricted and occupied by individuals whose income is 50% or less of the area median gross income.
- **40-60 Test —** At least 40% of the residential units in the project must be both rent restricted and occupied by individuals whose income is 60% or less of the area median gross income.
- **Average Income Test —** At least 40% (25% or more in the case of a project described in IRC §142(d)(6)) of the residential units in the project must be both rent restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer for the respective unit.

The low-income housing credit is determined by multiplying the qualified basis by the applicable credit percentage. The maximum applicable credit percentage allowable is determined partly by the date the building is placed in service. A minimum applicable credit percentage of 9% is effective for new **nonfederally** subsidized buildings placed in service after July 30, 2008.

CAA

NEW LAW[191]

Under the CAA, the minimum applicable credit percentage for any new or existing **federally subsidized** building placed in service by the taxpayer **after** December 31, 2020, is 4%. This percentage applies to:

- Any building that receives an allocation of housing credit dollar amounts after December 31, 2020; and
- For any building partly financed with an obligation described in IRC §42(h)(4)(A), any building if any obligation financing the building is issued after December 31, 2020.

Example 16. ABC Affordable Housing, LLC, secures the agreement of the Illinois Housing Development Authority to proceed with rehabbing a multifamily housing building in Rockford, Illinois, where the area median income is $44,252. The building without the land on which it is built has a basis of $2 million. ABC secures a mortgage for $1 million, and 10 investors contribute $100,000 each. Although the tax code permits the credit if only 20% of the tenants have income less than $22,126, ABC has all its apartment units occupied by tenants meeting this qualification when it accepts its first tenants on January 1, 2021. Because all apartments are occupied by tenants meeting the income criteria, the entire basis of the building is included in calculations. Consequently, each of the ten investors receives a 2021 Schedule K-1, *Shareholder's Share of Income, Deductions, Credits, etc.,* with a low-income housing tax credit allocation of $8,000 ($2 million × 4% ÷ 10 investors).

190. IRC §42; Instructions for Form 8609.

191. *Consolidated Appropriations Act of 2021,* PL 116-260, §201, Div. EE.

DEPRECIATION OF RESIDENTIAL RENTAL PROPERTY OVER 30 YEARS

OLD LAW[192]

For tax years beginning after December 31, 2017, the use of the alternative depreciation system (ADS) is required for depreciating residential rental property, nonresidential real property, and qualified improvement property (QIP) for real property trades or businesses **electing out of the interest deduction** limits implemented under the TCJA (i.e., an **electing real property trade or business).**[193] A **real property trade or business** for this purpose is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.[194]

The **interest deduction limits** are those introduced by the TCJA that disallow a deduction for net interest expense that is more than 30% of the adjusted taxable income of a business.[195]

The following ADS periods apply for real property.

- 40 years for nonresidential real property
- 30 years (reduced from 40 years) for residential rental property placed in service **after December 31, 2017**[196]
- 20 years for QIP

Note. Under the TCJA, QIP had a 40-year ADS recovery period, rather than the 20-year period that was intended. The CARES Act clarified that QIP is 15-year property under the modified accelerated cost recovery system (MACRS) and 20-year property under ADS. This provision applies for property placed in service after December 31, 2017.[197]

CAA

NEW LAW[198]

The CAA extends the application of the 30-year ADS recovery period to any residential rental property:

- Any residential rental property that was placed in service **before January 1, 2018;**
- Is held by an electing real property trade or business;[199] **and**
- Was not depreciated under ADS prior to January 1, 2018.

Note. The CAA provision applies the 30-year ADS recovery period to residential rental property held by an electing real property trade or business regardless of when the property was placed in service. As a result, taxpayers who elect out of the IRC §163(j) interest limitation rules benefit from depreciating their property over a shorter period of time. Taxpayers that did not elect out of the TCJA's interest deduction limits are not affected by this provision.

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192. *Tax Cuts and Jobs Act,* PL 115-97, §13204.

193. IRC §§168(g)(1) and (8), as amended by *Tax Cuts and Jobs Act,* PL 115-97, §13024.

194. IRC §469(c)(7)(C).

195. IRC §163(j), as amended by *Tax Cuts and Jobs Act,* PL 115-97, §13301.

196. IRC §168(g)(2)(C), as amended by *Tax Cuts and Jobs Act,* PL 115-97, §13204.

197. *CARES Act,* PL 116-136, §2307; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2021. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Aug. 10, 2021.

198. *Consolidated Appropriations Act of 2021,* PL 116-260, §202, Div. EE.

199. See IRC §163(j)(7)(B).

Example 17. DEF Residential Rentals, LLP, has $30 million in gross receipts and therefore is not eligible for small business $26 million gross receipts exception to the §163(j) interest expense limitation. It has $650,000 in interest expense associated with the apartment buildings it owns. However, because of the interest expense limitation, it is only able to claim interest expense of $300,000 because it has $1 million of adjusted taxable income before the interest expense and other provisions of §163(j)(8)(A) are considered. The other $350,000 is carried forward as excess business interest. DEF did not elect out because its management did not want to depreciate over 40 years the apartment buildings it purchased in 2017 and put into service in December of that year. However, with provision in §202 of the CAA, it can now depreciate the property over 30 years instead of 40 years and still deduct the full amount of the interest.

CAA

PROVISIONS PERMANENTLY EXTENDED

The following tax provisions were made permanent by the CAA.

CAA Section (Division EE, Sec. 1)	Code Section(s)	Description	Effective Date
101	213	Medical expense deduction floor reduced from 10% to 7.5%	Tax years beginning after Dec. 31, 2020
102	179D	Energy efficient commercial buildings deduction	Applies to property placed in service after Dec. 31, 2020
103	139B	Benefits provided to volunteer firefighters and emergency medical responders	Tax years beginning after Dec. 31, 2020
104	25A, 222, 62(a)(18), 74(d)(2)(B), 86(b)(2)(A), 135(c)(4)(A), 137(b)(3)(A), 219(g)(3)(A)(ii), 221(b)(2)(C)(i), 469(i)(3)(E)(iii)	Transition from deduction for qualified tuition and related expenses to increased limitation on lifetime learning credit	Tax years beginning after Dec. 31, 2020
105	45G	Railroad track maintenance credit	Tax years ending after Dec. 27, 2020 (date of enactment of CAA)
106(a)	263A	Production period for beer, wine, and distilled spirits	Interest costs paid or accrued after Dec. 31, 2020
106(b)	5051	Reduced rate of excise tax on beer	Applies to beer removed after Dec. 31, 2020
106(c)	5414	Transfer of beer between bonded facilities	Calendar quarters beginning after Dec. 31, 2020
106(d)	5041	Reduced rate of excise tax on certain wine	Applies to wine removed after Dec. 31, 2020

CAA Section (Division EE, Sec. 1)	Code Section(s)	Description	Effective Date
106(e)	5041	Adjustment of alcohol content level for application of excise tax rates	Applies to wine removed after Dec. 31, 2020
106(f)	5041	Definition of mead and low alcohol by volume wine	Applies to wine removed after Dec. 31, 2020
106(g)	5001	Reduced rate of excise tax on certain distilled spirits	Applies to distilled spirits removed after Dec. 31, 2020
106(h)	5212	Bulk distilled spirits	Applies to distilled spirits transferred in bond after Dec. 31, 2020
106(i)	5555	Simplification of rules regarding records, statements, and returns	Calendar quarters beginning after Dec. 31, 2020
107	5001, 5051, 5041, 6038E (new), 7652	Refunds in lieu of reduced rates for certain craft beverages produced outside the United States	Various
108	5067, 5068	Reduced rates not allowed for smuggled or illegally produced beer, wine, or spirits	Applies to beer, wine, or distilled spirits produced after Dec. 27, 2020
109	5001	Minimum processing requirements for reduced distilled spirits rates	Applies to distilled spirits removed after Dec. 31, 2021
110	5051, 5041, 5001	Modification of single taxpayer rules (regarding beer, wine, and distilled spirits)	Applies to beer, wine, and distilled spirits removed after Dec. 31, 2020

CAA

PROVISIONS TEMPORARILY EXTENDED

The tax provisions extended by the CAA are summarized in the following table.

CAA Section (Division EE, Sec. 1)	Code Section(s)	Description	Previous Expiration Date	New Expiration Date
111	954(c)(6)(C)	Look-through rule for related controlled foreign corporations	Dec. 31, 2020	Dec. 31, 2025
112	45D(f)	New markets tax credit	Dec. 31, 2020	Dec. 31, 2025
113	51(c)(4)	Work opportunity credit	Dec. 31, 2020	Dec. 31, 2025
114	108(a)(1)(E), 108(h)(2)	Exclusion from gross income of discharge of qualified principal residence indebtedness	Dec. 31, 2020	Dec. 31, 2025
115	168(i)(15)(D)	7-year recovery period for motorsports entertainment complexes	Dec. 31, 2020	Dec. 31, 2025
116	181(g)	Expensing rules for certain productions (qualified film, television, or live theatrical)	Dec. 31, 2020	Dec. 31, 2025
117	4611(f)(2)	Oil spill liability trust fund rate	Dec. 31, 2020	Dec. 31, 2025
118	1391(d)(1)(A)(i), 1397A, 1397B	Empowerment zone tax incentives	Dec. 31, 2020	Dec. 31, 2025
119	45S(i)	Employer credit for paid family and medical leave	Dec. 31, 2020	Dec. 31, 2025
120	127(c)(1)(B)	Exclusion for certain employer payments of student loans	Dec. 31, 2020	Dec. 31, 2025
121	45Q(d)(1)	Extension of carbon oxide sequestration credit	Dec. 31, 2023	Dec. 31, 2025
131	45(d), 48(a)(5)(C)(ii), 45(b)(5)(D), 48(a)(5)(E)(iv)	Credit for electricity produced from certain renewable resources	Dec. 31, 2020	Dec. 31, 2021

CAA Section (Division EE, Sec. 1)	Code Section(s)	Description	Previous Expiration Date	New Expiration Date
132(a)	48 (various subsections)	Extensions of energy credit	Dec. 31, 2021	Dec. 31, 2023
132(b)	48 (various subsections)	Phaseout of energy credit	Various	Various
133	163(h)(3)(E)(iv)(I)	Treatment of mortgage insurance premiums as qualified residence interest	Dec. 31, 2020	Dec. 31, 2021
134	35(b)(1)(B)	Credit for health insurance costs of eligible individuals	Dec. 31, 2020	Dec. 31, 2021
135	45A(f)	Indian employment credit	Dec. 31, 2020	Dec. 31, 2021
136	45N(e)	Mine rescue team training credit	Dec. 31, 2020	Dec. 31, 2021
137	168(e)(3)(A)(i)	Classification of certain race horses as 3-year property	Dec. 31, 2020	Dec. 31, 2021
138	168(j)(9)	Accelerated depreciation for business property on Indian reservations	Dec. 31, 2020	Dec. 31, 2021
139	119(d) of division A of the Tax Relief and Health Care Act of 2006	American Samoa economic development credit	Dec. 31, 2020	Dec. 31, 2021
140	40(b)(6)(J)(i)	Second generation biofuel producer credit	Dec. 31, 2020	Dec. 31, 2021
141	25C(g)(2)	Nonbusiness energy property	Dec. 31, 2020	Dec. 31, 2021
142	30B(k)(1)	Qualified fuel cell motor vehicles	Dec. 31, 2020	Dec. 31, 2021
143	30C(g)	Alternative fuel refueling property credit	Dec. 31, 2020	Dec. 31, 2021

CAA Section (Division EE, Sec. 1)	Code Section(s)	Description	Previous Expiration Date	New Expiration Date
144	30D(g)(3)(E)(ii)	2-wheeled plug-in electric vehicle credit	Dec. 31, 2020	Dec. 31, 2021
145	45(e)(10)(A)	Production credit for Indian coal facilities	Dec. 31, 2020	Dec. 31, 2021 [a]
146	45L(g)	Energy efficient homes credit	Dec. 31, 2020	Dec. 31, 2021
147	6426(d)(5), 6426(e)(3), 6427(e)(6)(C)	Extension of excise tax credits relating to alternative fuels	Dec. 31, 2020	Dec. 31, 2021
148	25D (various subsections), 25C (various subsections)	Extension of residential energy-efficient property credit and inclusion of biomass fuel property expenditures	Dec. 31, 2021	Dec. 31, 2023
149	4121(e)(2)(A)	Black lung disability trust fund excise tax	Dec. 31, 2020	Dec. 31, 2021

[a] The provision applies to coal produced by the taxpayer at an Indian coal production facility during the 16-year period beginning on Jan. 1, 2006, and sold during such 16-year period and such tax year. The **16-year period** ends Dec. 31, 2021. Before the CAA was enacted, the provision applied to coal produced and sold by the taxpayer during the **15-year period** beginning on Jan. 1, 2006. The 15-year period ended Dec. 31, 2020.