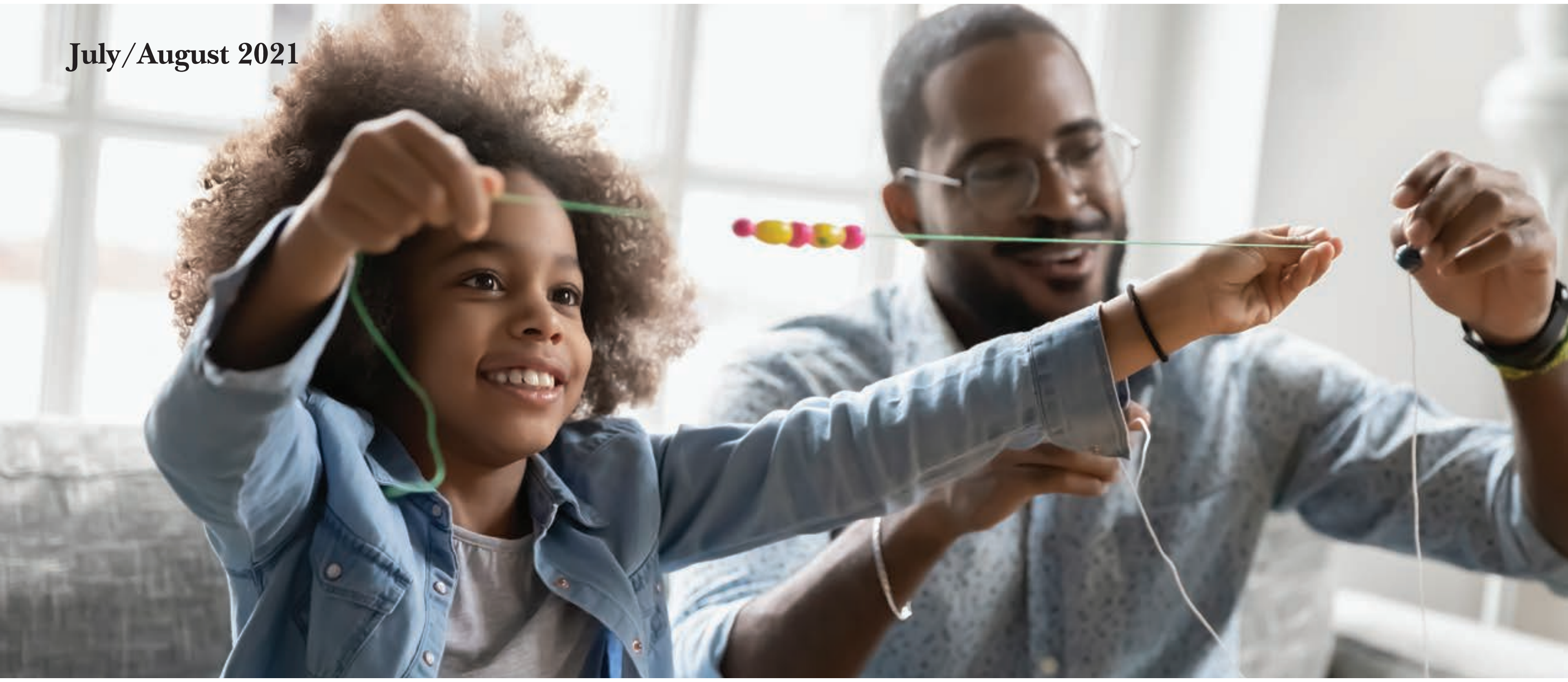
Tax Impact



July/August 2021

Parents: Reap tax benefits this year

With a price tag of nearly $2 trillion, the American Rescue Plan Act (ARPA) is one of the biggest economic stimulus measures in U.S. history. The legislation offers some significant tax benefits for parents in 2021, including temporary increases in the child tax credit (CTC) and the child and dependent care credit (CDCC) for eligible families. It also provides for monthly advance payments of a portion of the child tax credit starting in July and allows parents to claim the credit for 17-year-olds (previously the cut-off age was 16).

Child tax credit

Ordinarily, the CTC is $2,000 per dependent child under the age of 17 (as of the last day of the tax year). The CTC is partially refundable — if your credit exceeds your tax liability, the IRS will send you a check for the difference (up to $1,400), provided your earned income is at least $2,500.

The CTC begins to phase out when a parent's modified adjusted gross income (MAGI) reaches $200,000 ($400,000 for joint filers). It's reduced by $50 for each $1,000 (or fraction thereof) by which your MAGI exceeds the applicable threshold. So, for example, if you have one qualifying child, the $2,000 credit drops to zero when your MAGI tops $239,000 ($439,000 for joint filers). If you have two qualifying children — for a total credit of $4,000 — those thresholds increase to $279,000 and $479,000, respectively.

For 2021 only, the ARPA increases the CTC to $3,600 for each child under the age of six and $3,000 for each child age six through 17 as of the last day of the tax year (ordinarily, 17-year-olds are ineligible). It also makes the credit fully refundable (for most U.S. residents) and eliminates the $2,500 earned income requirement.

The ARPA establishes two sets of phase-out thresholds for 2021:

- The *additional* credit amount — $1,000 per qualifying child ($1,600 per qualifying child under age six) — begins to phase out when MAGI reaches $75,000 ($150,000 for joint filers). For example, if you have two qualifying children over age six, the additional credit would be completely phased out at MAGI of $115,000 ($190,000 for joint filers).
- The remaining $2,000 in credit begins to phase out at the pre-ARPA income levels outlined above (MAGI of $200,000; $400,000 for joint filers).

If you're eligible for the CTC in 2021, the ARPA allows you to enjoy the benefits during the year, rather than waiting until you file your return in 2022. (See "Advance CTC payments start in July" at right.)

Child and dependent care credit

You're eligible for the CDCC if you pay someone to care for your children (under age 13) or certain other dependents so you (or your spouse) can work or look for work. Ordinarily, the maximum nonrefundable credit is 35% of up to $3,000 in qualifying expenses ($6,000 for two or more qualifying dependents).

But that percentage is gradually reduced (to a minimum of 20%) if your adjusted gross income (AGI) exceeds $15,000. In other words, except for those with modest incomes, the maximum credit is $600 (20% x $3,000) for one qualifying dependent and $1,200 (20% x $6,000) for two or more qualifying dependents.

For 2021 only, the ARPA makes several modifications to the CDCC, including:

- Increasing the expense limits to $8,000 for one qualifying dependent and $16,000 for two or more.
- Increasing the maximum credit rate to 50% (from 35%) of those expenses.
- Increasing the AGI threshold at which the credit rate is reduced to $125,000 (from $15,000). The rate is reduced by 1% for each $2,000 (or fraction thereof) in excess of the threshold. Thus, the rate drops from 50% to 20% when AGI exceeds $183,000.
- Phasing out the 20% credit by 1% for each $2,000 (or fraction thereof) by which AGI exceeds $400,000, thereby reducing the credit to zero when AGI exceeds $438,000.

Advance CTC payments start in July

Ordinarily, you claim the child tax credit (CTC) on your tax return and apply it toward reducing your tax liability or increasing your refund. But for 2021 only, families eligible for the CTC can start receiving its benefits during the year. The American Rescue Plan Act provides for six monthly advance credit payments from July through December 2021.

The monthly amount is calculated by taking your estimated credit amount (based on your 2019 or 2020 tax return) and dividing it by 12. So, unless you opt out of advance payments, you'll receive roughly half of the credit amount during the second half of 2021 and claim the remaining credit on your 2021 return (subject to adjustment if your 2021 MAGI is different than the amount used to estimate the credit).

Why would you opt out of advance payments? Perhaps you'd prefer to take the full credit on your 2021 return to maximize your refund. Or perhaps you expect your 2021 income to affect your eligibility for the credit, and you wish to avoid having to repay some or all of the advances.

To summarize: If your AGI is $125,000 or less, your maximum CDCC is $4,000 for one qualifying dependent or $8,000 for two or more qualifying dependents. The maximum credits gradually drop to $1,600/$3,200 for AGI of $185,001 to $400,000, then gradually drop to zero when AGI exceeds $438,000.

Stay tuned

Remember, the enhanced CTC and CDCC are available only in 2021. However, it's possible that Congress will extend these benefits to 2022 or beyond. Keep in touch with your tax advisor for the latest information. ■

Complete your estate plan by adding a power of attorney

As you create your estate plan, your main objectives likely revolve around your family, both current and future generations. Your goals may include reducing estate tax liability so that you can pass as much wealth as possible to your loved ones.

But it's also critical to think about yourself. What if you become incapacitated and are unable to make financial and medical decisions? Thus, a crucial component to include in your plan is a power of attorney (POA).

What is a POA?

A POA is defined as a legal document authorizing another person to act on your behalf. This person is referred to as the "attorney-in-fact" or "agent" — or sometimes by the same name as the document, "power of attorney."

A POA can be either specific or general. A general POA is broader in scope. For example, you might use a general POA if you frequently take extended trips out of the country and need someone to authorize business and investment transactions while you're gone.

However, a specific or general POA is no longer valid if you're incapacitated. For many people, this is actually when the authorization is needed the most. Therefore, to thwart dire circumstances, you can adopt a "durable" POA.

A durable POA remains in effect if you become incapacitated and terminates only on your death. Thus, it's generally preferable to a regular POA. The document must include specific language required under state law to qualify as a durable POA.

Who should you name as POA?

Despite the name, your POA doesn't necessarily have to be an attorney, although that's an option.

Typically, the designated agent is either a professional, like an attorney, CPA or financial planner, or a family member or close friend. In any event, the person should be someone you trust implicitly and who is adept at financial matters.

> ***A durable POA remains in effect if you become incapacitated and terminates only on your death.***

Regardless of whom you choose, it's important to name a successor agent in case your top choice is unable to fulfill the duties or predeceases you.

Usually, the POA will simply continue until death. However, you may revoke a POA — whether it's durable or not — at any time and for any reason. If you've had a change of heart, notify the agent in writing about the revocation. In addition, notify other parties who may be affected.

What about health care decisions?

A durable POA can also be used for health care decisions. For instance, you can establish the terms for determining if you're incapacitated. It's important that you discuss these matters in detail with your agent to give him or her more direction.

Don't confuse a POA with a living will. A durable POA gives another person the power to make decisions in your best interests. In contrast, a living will provides specific directions concerning terminally ill patients.

Final thoughts

To ensure that your health care and financial wishes are carried out, consider preparing and signing a POA as soon as possible. Also, don't forget to let your family know how to gain access to the POA in case of emergency. Finally, health care providers and financial institutions may be reluctant to honor a POA that was executed years or decades earlier. So, it's a good idea to sign a new document periodically. ■

Merging for tax dollars

The COVID-19 pandemic has had an enormous impact on the economy, but different types of businesses have been affected differently. Some businesses — such as restaurants, bars, entertainment venues, airlines and other transportation companies — have suffered significant losses as a result of lockdowns, travel restrictions and other disruptions. Others — such as health care providers, technology firms and e-commerce companies — have flourished. Still others have seen little or modest impact on their performance.

As the struggles continue, many corporations have found themselves with net operating losses (NOLs) and other tax benefits they won't be able to use in the foreseeable future, while others have enjoyed unusually high profit levels. One potential strategy for these corporations is to combine through a merger or acquisition, so that one corporation's losses can be offset against the other company's profits. If the strategy is successful, it allows one corporation to take advantage of tax benefits that might otherwise go unused, while reducing the other company's tax liability.

If you're contemplating such a transaction, careful planning is critical. The tax code authorizes the IRS to disallow tax benefits associated with an acquisition that's motivated primarily by tax evasion or avoidance. So, to preserve these benefits, the parties must be able to demonstrate one or more legitimate business purposes for the combination.

Beware IRC Section 269

Internal Revenue Code (IRC) Section 269, "Acquisitions made to evade or avoid income tax," states that the U.S. Secretary of the Treasury may disallow a deduction, credit or other allowance obtained through an acquisition if the principal purpose of that acquisition is to evade or avoid tax. An acquisition subject to Sec. 269 happens when "any person or persons acquire, directly or indirectly, control of a corporation." It also includes certain asset transfers. "Control" is defined as ownership of stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote, or at least 50% of the total value of shares of all classes of stock.

Significantly, Sec. 269 doesn't disallow *all* tax benefits obtained through acquisition. It applies if tax avoidance is the only *principal purpose* of the transaction. The term "principal purpose" is subject to interpretation, but, in general, the more "legitimate" business purposes the parties can offer for joining forces the more likely it is that NOLs or other tax benefits will be allowed.

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Potential legitimate business purposes include:

- Expanding,
- Diversifying,
- Increasing borrowing capacity,
- Limiting liability or reducing risk,
- Obtaining new distribution channels,
- Securing control of the supply chain or otherwise gaining the benefits of vertical integration,
- Achieving economies of scale, and
- Reducing administrative expenses.

Keep in mind that even if you clear the hurdle imposed by Sec. 269, other tax code provisions may limit your ability to use tax benefits after an acquisition. For example, IRC Sec. 382 places limits on NOL carryforwards and certain other loss deductions following an ownership change.

Weigh your options

If your company generated NOLs in 2020, the first option to consider is carrying them back to offset gains in previous years and claiming a refund. The CARES Act allows you to carry back NOLs generated in 2018, 2019 and 2020 for up to five years. If that isn't an option, being acquired by a profitable corporation might be worth considering. ■

Tax Tips

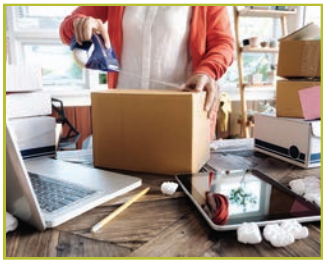
Strategies for minimizing RMDs

The CARES Act suspended required minimum distributions (RMDs) from IRAs and qualified retirement plans in 2020. No such relief was provided for 2021, however, so if you've already started taking RMDs or if you'll turn 72 by December 31, 2021, you'll need to take an RMD this year (or by April 1, 2022, if it's your first RMD) and pay tax on it. Now's a good time, therefore, to consider strategies for reducing or eliminating RMDs. Options include:

- Performing a Roth IRA conversion. Although the conversion will trigger income taxes on the converted amount, it'll eliminate the need to take RMDs in future years.
- Naming a younger spouse (by more than 10 years) as sole beneficiary. Doing so allows you to shrink RMDs by spreading them out over your joint life expectancies.
- Continue working. Doing so may allow you to delay RMDs from your current employer's qualified retirement plan, though it won't affect RMDs from IRAs or previous employers' plans.
- Enter into a Qualified Longevity Annuity Contract (QLAC). This year, you can fund a QLAC with up to 25% of your retirement account balance or $135,000, whichever is less, and defer RMDs on those funds until annuity payments begin at age 85.

Are your online sales taxable?

If you sell items via ebay, Etsy or other similar online sites, the payments you receive may be considered taxable business income. But even if your profits from these activities are substantial, historically they've been difficult for the IRS to discover. That may no longer be the case, however, starting next year. Currently, online sales platforms that use third-party transaction networks (such as PayPal) are required to send you Form 1099-K, and file it with the IRS, if you engage in a minimum of 200 transactions totaling at least $20,000. But starting in 2022, this threshold will drop to only $600, with no transaction minimum. Keep in mind that, depending on your situation, your sales may or may not be taxable, regardless of whether you receive Form 1099-K. So, if you engage in significant online sales, consult your tax advisor to discuss your tax obligations.



Paid sick leave and paid family and medical leave credit extended

Legislation passed in 2020 required private businesses with fewer than 500 employees to provide paid sick leave and paid family and medical leave to certain employees affected by the COVID-19 pandemic, offset by refundable payroll tax credits. In the Consolidated Appropriations Act, Congress declined to extend mandatory paid leave into 2021, but made tax credits available to private businesses, with fewer than 500 employees, that voluntarily offered similar paid leave through March 31, 2021. The American Rescue Plan Act extended this benefit through September 2021. ■