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TaxBrief

Keeping you informed January 2021

The recently passed *Consolidated Appropriations Act, 2021*, provides additional relief to taxpayers impacted by the COVID-19 pandemic. Here's a brief overview of some of the key provisions.

Stimulus payment rebate

A second refundable recovery rebate credit for 2020, paid in advance to eligible individuals, began at the end of 2020 and continues into 2021. These payments are in addition to the economic impact payments previously provided.

The amount of the rebate is $600 per eligible taxpayer ($1,200 for married filing jointly), plus $600 per qualifying child under age 17. The credit is phased out at a rate of $5 per $100 of additional income starting at $150,000 of modified adjusted gross income for those filing tax returns jointly or as surviving spouses, $112,500 for heads of household and $75,000 for single taxpayers.

The advance payments will be based on the information on 2019 tax returns. Nonresident aliens, persons who qualify as another person's dependent, and estates or trusts don't qualify for the rebate. Taxpayers without a Social Security number are also ineligible. However, if only one spouse on a joint return has a Social Security

number, that spouse is eligible for a $600 payment. Children must also have a Social Security number to qualify for the $600-per-child payments.

Taxpayers who receive an advance payment exceeding the amount of their eligible credit (as later calculated on the 2020 return) will not have to repay any of the overpayment. If the amount of the credit determined on the taxpayer's 2020 return exceeds the amount of the advance payment, taxpayers receive the difference as a refundable tax credit.

Advance payments of the rebates are generally not subject to offset for past-due federal or state debts, and they are protected from bank garnishment or levy by private creditors or debt collectors.

Deductions

For eligible taxpayers, the following deductions are available:

- The $250 **educator expense deduction** applies to PPE and other COVID-related supplies. Eligible educators (i.e., kindergarten through grade 12 teachers, instructors, etc.) can claim the existing $250 above-the-line educator expense deduction for personal protective equipment, disinfectant and other supplies purchased after March 12, 2020, and used for the prevention of the spread of COVID-19.
- The 7.5%-of-adjusted-gross-income threshold on **medical expense deductions** has been made permanent. It was scheduled to increase to 10% of adjusted gross income after 2020.
- The **mortgage insurance premium deduction**, subject to a phaseout based on the taxpayer's adjusted gross income, has been extended through the end of 2021.
- The above-the-line **charitable contribution deduction** is extended through 2021. For 2020, individuals who don't itemize deductions can take up to a $300 ($150 if married filing separately) above-the-line deduction for cash contributions to qualified charitable organizations. This deduction remains through 2021 and increases the deduction allowed on a joint return to $600 (it remains at $300 for all other taxpayers). Overstating this deduction is subject to a 50% penalty.

Tax credits

Take note of the following updates on these popular credits:

- Individuals may elect to base a 2020 refundable **child tax credit** (CTC) and **earned income credit** (EIC) on 2019 earned income. If an individual's CTC exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15% of the amount of the taxpayer's taxable earned income for the tax year that exceeds $2,500. The EIC equals a percentage of the taxpayer's earned income. For both credits, earned income means wages, salaries, tips and other employee compensation if includible in gross income for the tax year. To determine the refundable CTC and the EIC for 2020, taxpayers can elect to substitute the earned income for the preceding tax year if that amount is greater than the taxpayer's earned income for 2020.
- The **residential energy-efficient property (REEP) credit** is extended two years. Used by individual taxpayers for qualified property and due to expire at the end of 2021, the phase-down period of the REEP credit is extended through Dec. 31, 2023.

Exclusions from income

The following items are excluded from income:

- The exclusion for **benefits provided to volunteer firefighters and emergency medical responders** is made permanent. Emergency workers who are members of a qualified volunteer emergency response organization can exclude from gross income certain state or local government payments received and state or local tax relief provided on account of their volunteer services.
- The exclusion for **discharge of qualified mortgage debt** is extended, but limits on the amount of excludable discharge are lowered. Usually, if a lender cancels a debt, such as a mortgage, the borrower must include the discharged amount in gross income. Under an exclusion that was due to expire at the end of 2020 but was extended through the end of 2025, a taxpayer can exclude from gross income up to the applicable threshold qualified principal residence debt discharged. The threshold was $2 million ($1 million for married filing separately) for discharges of indebtedness before Jan. 1, 2021. After 2020, it is reduced to $750,000 ($375,000 for married filing separately).
- The exclusion for certain e**mployer payments of student loans** is extended. Qualifying educational assistance provided under an employer's qualified educational assistance program, up to an annual maximum of $5,250, is excluded from the employee's income through 2025. For the types of payments that are eligible for this exclusion, the CARES Act added "eligible student loan repayments" made after March 27, 2020, and before Jan. 1, 2021, which was extended through Dec. 31, 2025. These payments, which are subject to the overall $5,250 per-employee limit for all educational payments, are payments of principal or interest on a qualified student loan by the employer, whether paid to the employee or a lender. Additional educational assistance program requirements apply to shareholders.

Disaster-related changes in retirement plan rules

The *Consolidated Appropriations Act, 2021*, also eases the following retirement plan rules:

- The **10% early withdrawal penalty** does not apply to qualified disaster distributions from retirement plans. A 10% early withdrawal penalty generally applies to, among other things, a distribution from an employer retirement plan to an employee who is under age 59½. However, the 10% early withdrawal penalty doesn't apply to any qualified disaster distribution from an eligible retirement plan. The aggregate amount of distributions received by an individual that may be treated as qualified disaster distributions for any tax year may not exceed the excess (if any) of $100,000, over the aggregate amounts treated as qualified disaster distributions received by that individual for all prior tax years.
- The **limit for plan loans** made because of a qualified disaster has increased. Generally, a loan from a retirement plan to a retirement plan participant cannot exceed $50,000. Plan loans over this amount are considered taxable distributions to the participant. The allowable amount of a loan from a retirement plan was increased to $100,000 if the loan is made because of a qualified disaster and meets various other requirements.

Important note

As always, I'm here for you during these trying and often confusing times. COVID-19 is affecting each of us in a unique way, and I'm proud to be a reliable, knowledgeable and sympathetic resource for you as we continue to move forward. Please stay safe and healthy!