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Tax Newsletter

ARPA Authorizes COBRA Subsidies
Temporary relief in new law

The new American Rescue Plan Act (ARPA) includes relief for both individuals and businesses. Case in point: A key provision in the new law provides tax-free COBRA subsidies to ex-employees for a limited period of time. To top things off, employers are entitled to a payroll tax credit for the resulting costs.

Background: Under the federal law known as COBRA—short for the Consolidated Omnibus Budget Reconciliation Act—a company with 20 or more employees in the prior year is obligated to offer continued health insurance coverage to employees that lose their coverage due to a "qualifying event."

For these purposes, coverage may be extended to the employee, a spouse and dependent children under age 26.

Generally, the ex-employee is required to pay the health insurance premiums. In addition, the employer can tack on an extra 2% for administrative expenses.

The list of qualifying events includes the following:

- Termination of the covered employee's employment (other than for gross misconduct);
- Reduction in the number of hours of employment;
- The covered employee becomes entitled to Medicare;
- Divorce or legal separation of the covered employee's spouse;
- Death of the covered employee; or
- Loss of dependent child status under the plan rules.

If the qualifying event is termination of employment or a reduction in hours of employment, the employee is entitled to 18 months of coverage. In certain other situations, the maximum is 36 months.

New law change: ARPA authorizes a temporary subsidy equal to 100% of the health insurance premiums required under COBRA. It is available to qualified beneficiaries who are eligible for COBRA coverage between April 1, 2021, and September 30, 2021, due to an involuntary termination of employment or a reduction in hours.

These individuals do not owe a dime in premiums. After the September 30 end date, qualified beneficiaries may continue coverage if they elect to pay the premiums.

In addition, qualified beneficiaries get a "second chance" at electing coverage if they previously passed up this option. However, coverage may be extended only for the remaining time of the original COBRA coverage period. Furthermore, the employer may allow the employee to enroll in a different plan as long as the plan does not have higher premiums than the one the employee had at the time of the qualifying event.

Employers must meet **three key notification requirements** relating to the COBRA subsidy.

1. Notify by May 31, 2021, individuals who became eligible for premium assistance before April 1, 2021 (including any option to enroll in different coverage).

2. Notify by May 31, 2021, individuals who are getting a second chance to elect continued health insurance.

3. Notify individuals whose COBRA premium assistance period is about to expire at least 15 days before the expiration date (but not more than 45 days). The notice must inform them that they may be eligible for unsubsidized coverage through COBRA.

Notably, ARPA temporarily shifts the burden for paying health insurance premiums from ex-employees to employers. However, employers will be eligible for a refundable tax credit against payroll taxes. If the tax credit will be refunded, an employer may be able to obtain advanced payment.

Final words: The details involving the credit are still being worked out. After the IRS issues guidance, we will provide an update.

Big Improvements to Child Tax Credit
Key tax law changes for 2021 only

Congress keeps raising the stakes for the Child Tax Credit (CTC). Following other recent tax law changes, the new American Rescue Plan Act (ARPA) includes several significant enhancements to the CTC for 2021. What's more, these tax breaks will start paying off in July—not when you file your 2021 tax return.

Background: Prior to ARPA, the maximum CTC for 2018 through 2025 was $2,000 for each qualifying child under age 17 (increased from $1,000 before 2018). Up to $1,400 of the $2,000 maximum credit was refundable.

To qualify, the child had to live with you for at least six months during the year, not provide more than half of their own support and be a U.S. citizen, national or resident alien. You also had to provide the child's name and Social Security number (SSN) on your return to claim the credit.

However, the CTC was subject to a phase-out based on modified adjusted gross income (MAGI). For 2018 through 2025, the phase-out was scheduled to begin at $200,000 of MAGI for single filers and $400,000 for joint filers. The credit was phased out by $50 per $1,000 (or fraction of $1,000) of MAGI above the threshold.

Now ARPA revises the rules for 2021. Generally, the changes are favorable to taxpayers. This includes the following:

- The maximum credit is increased from $2,000 to $3,000 for a qualifying child. Even better: The CTC goes up to $3,600 for qualifying children under age six. As before, there is no limit on the number of qualifying children.

- The definition of a qualifying child is expanded to include children under age 18 (up from age 17) at the end of the year. This gives some parents an extra year to claim the CTC.

- The credit is fully refundable. For example, if you have two children qualifying for the $3,000 credit, you can cash in on a refund as high as $6,000.

- On the downside, the credit begins to phase out at lower income levels. For 2021, the phase-out begins at $75,000 of MAGI for single filers and $150,000 for joint filers (down from $200,000 and $400,000, respectively). However, taxpayers affected by the new phase-out ranges can elect to claim the $2,000 credit under the prior rules.

- Finally, you do not have to wait to realize the benefits of the increased CTC. The IRS expects to begin sending advance monthly payments of up to 50% of the allowable 2021 CTC in July and intends to finish in December.

To determine your advance payments, the IRS will refer to information on your 2020 Form 1040 (or your 2019 return if your 2020 return has not yet been filed). However, if the IRS determines that it is not feasible to make monthly advance credit payments, it can arrange advance payments based on longer intervals and adjust the monthly payments accordingly. Expect more guidance from the IRS soon.

Caveat: The ARPA changes for the CTC are effective for 2021 only. After 2021, barring any further legislation, the rules go back to the way they were before.

Compare the Two Types of IRAs
How traditional and Roth IRAs differ

As you are probably know, there are two basic types of IRAs: the traditional IRA and the Roth IRA. With either one, the deadline for contributions for the 2020 tax year is May 17, 2021 (extended from April 15, 2021). There are no further extensions even if you obtain the regular "automatic extension" for filing your return.

It is important to know the similarities and distinctions for the two types of IRAs. For starters, the annual limit for contributions to either IRA for the 2020 tax year (or any combination) is $6,000. (It remains the same in 2021.) Plus, you can add another $1,000 if you are age 50 or over for a total of $7,000. There is no current tax on the contributions and earnings within any IRA.

Generally, you can contribute to an IRA if you have earnings or other compensation from a job. However, the ability to contribute to a Roth IRA is limited or eliminated for certain high-income taxpayers. Here are the other main differences to keep in mind.

1. **Traditional IRAs:** Contributions may be wholly or partially deductible. But deductions are phased out if your modified adjusted income (MAGI) exceeds a specified level and you (or your spouse if you are married) are an active participant in an employer-sponsored retirement plan. Therefore, for many individuals, no part of the contribution to a traditional IRA is tax-deductible.

When you receive distributions from a traditional IRA, you are taxed at ordinary income tax rates on the portion representing deductible contributions and earnings. In addition, you will have to pay a 10% penalty tax on withdrawals made before age 59½, unless one of the special tax law exceptions applies.

2. **Roth IRAs:** As opposed to a traditional IRA, contributions to a Roth are never tax-deductible, regardless of your MAGI. But there is a potential payoff on the back end that you cannot realize with a traditional IRA: Qualified distributions from a Roth in existence for at least five years are 100% tax-free. For this purpose, qualified distributions include withdrawals made after age 59½, those made or on account of death or disability or those used to pay qualified first-time homebuyer expenses (up to a lifetime limit of $10,000).

Other distributions are taxed at ordinary income rates under special “ordering rules.” Contributions are treated as coming out first, followed by conversion and rollover amounts and then earnings. Thus, even if you do not receive qualified distributions, part or all of the payout may be tax-free.

Due to the lure of tax-free distributions, you might consider converting some or all of the funds in your traditional IRA to a Roth IRA. But be aware that the conversion itself is taxable at ordinary income rates just like a withdrawal. Also, if you must use funds being transferred to pay the resulting conversion tax, it will dilute some of the tax benefit.

Which type of IRA is best for you? It depends on a number of variables, such as your current and future expected tax rates, as well as other personal circumstances. Rely on your professional advisors for guidance.

Late Tax Break on Unemployment Benefits

Normally, unemployment benefits are subject to federal income tax. However, under the American Rescue Plan Act (ARPA), the first $10,200 of benefits received in 2020 is excluded from tax for a taxpayer with an adjusted gross income (AGI) of up to $150,000. If you exceed the $150,000-of-AGI threshold, the benefits are fully taxable.

If you have already filed your 2020 return, you do not have to file an amended return. The IRS will begin distributing payments in May and finish in the summer.

Caution: State law may vary. Check with your tax advisor concerning your personal situation.

Texas Tax Relief Reminder

A reminder that the IRS has extended deadlines for filing various tax returns and making tax payments for victims of the severe winter storms in Texas and affected taxpayers in other FEMA-declared disaster areas. Texas residents and taxpayers now have until June 15, 2021, to file individual, trust and business returns normally due on April 15th and business returns normally due on March 15th. Tax exempt organizations returns normally due on May 15th are also extended to June 15th. The June 15th deadline also applies to 2021 quarterly estimated tax payments due on April 15th and quarterly payroll and excise tax returns due on April 30th.

Additionally, the Texas Comptroller’s Office Extends Franchise tax deadline due date for 2021 franchise tax reports from May 15th to June 15th.

Facts and Figures
Timely points of particular interest

Summertime Credit—If your business hires youths age 16 or 17 residing in an empowerment zone, enterprise community or renewal community, it may qualify for a special summertime version of the Work Opportunity Tax Credit (WOTC). It is available for wages paid for services performed between May 1 and September 15. Although the maximum WOTC is generally $2,400 per worker, the maximum summertime credit is $1,200 per worker. To qualify, you must meet certain certification requirements.

Food for Thought—Usually, a business can deduct 50% of the cost of qualified business meals. But the Consolidated Appropriations Act (CAA) authorized a 100% deduction for food or beverages purchased by a business from a restaurant for 2021 and 2022. Now the IRS has clarified that this tax break applies to take-out fare as well as in-restaurant services, but it is not available for businesses that primarily sell pre-packaged goods that are not for immediate consumption, like grocery and convenience stores.

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