Setting Sail

Second Quarter 2021

IRS Extends Tax Filing Deadline for Second Straight Year

Procrastinators around the country can rejoice for a second year as the IRS announces that the traditional tax filing deadline of April 15th has been extended to May 17, 2021 for 2020 individual tax returns. However, this seemingly simple declaration comes with some complexities that I would like to cover.

First, this is an automatic extension that doesn't require any paperwork. So, if you can get your tax forms completed by May 17th, there is no need to worry about filing for an extension. However, if you need even more time, you can file IRS Form 4868 to extend your tax filing due date until October 15th.

With this automatic filing extension comes an extension to pay any remaining 2020 income taxes without penalty or interest until May 17th. However, if you plan on filing an extension beyond May 17th the taxes are still due in May so be sure to send in some money with an extension request to avoid penalties and interest.

But, when it comes to estimated tax payments for 2021, the first payment remains due on April 15, 2021. Many taxpayers who make estimated tax payments need to complete their prior year's taxes to calculate an appropriate amount of estimated tax payments. Unfortunately, these poor souls' choices amount to either completing their taxes by April 15th, so they know how much to make in estimated payments, guess on the estimated tax payment, or skip the estimate and deal with the penalty that follows.

On the positive side, IRA and HSA contributions can be made for 2020 up to the new tax filing deadline of May 17th. Also, states have updated their deadlines to match the IRS. Idaho and Utah are among them, so you have until May 17th to file your state income taxes in these states.

Setting Sail is written by **Alan S. Campbell, MBA, CFP®** and published quarterly by **Spinnaker Financial Advisors, LLC,** a Registered Investment Adviser. The firm provides ***fee-only*** wealth management services, including investment advisory and management services and comprehensive financial planning and consulting.

Unpacking the American Rescue Plan of 2021

The third round of COVID-19 economic stimulus, officially known as the American Rescue Plan Act of 2021, was signed into law by President Biden on March 11th. The $1.9 trillion package contains an assortment of relief for various individuals and institutions with money going everywhere from state and local governments, schools, transportation and infrastructure, and coronavirus testing and vaccination efforts. In addition, individuals were treated to a third round of direct payments and the tax code was used as a tool to get money into the hands of individuals and families. Let's take a look at some of the tax provisions included in this historic stimulus.

2021 Recovery Rebates – Stimulus Checks

By this point, we all know the drill with direct payments to individuals. Some of us were treated to Trump Bucks in spring 2020, Lame-Duck Bucks in winter 2020-2021, and now we have Biden Bucks. As with the prior iterations, these direct payments are tax credits paid in advance. In this case, they are 2021 tax credits, whereas the previous rounds were 2020 tax credits that you may have recently received with your 2020 tax refund if you didn't receive them earlier. Also, the amount of the rebates, dependents eligible, and income thresholds have changed this time.

The 2021 Recovery Rebates start at a base amount of $1,400 per taxpayer and their dependents, regardless of age. This may include older teenagers and college-aged students not included in previous stimulus checks or aging dependent parents. From this base amount, the rebate may be reduced or eliminated if the taxpayer's income falls in or above the following phaseout ranges:

- Single and Married Filing Separate - $75,000 -- $80,000
- Head of Household - $112,500 -- $120,000
- Married Filing Joint - $150,000 -- $160,000

Compared to previous stimulus phaseout ranges, these are incredibly tight phaseout ranges where every dollar of income within these ranges could make a difference in the amount of rebates received especially as the number of individuals in a family goes up. This begs the questions, what tax year counts as income to qualify for the stimulus checks? The short answer is either 2019, 2020, or maybe 2021.

The initial wave of direct deposits, checks in the mail, and prepaid debit cards that are being processed in the weeks following the bill's passage are based on the most recent tax return the IRS has on file, either 2019 or 2020. If a taxpayer qualifies based on their income, they will receive the full or partial stimulus.

As a second checkpoint, the IRS will rerun the numbers based on 2020 tax returns received as of August 15, 2021. It is possible to file an extension until Oct 15th to file taxes, but if you would like to use your 2020 income figures to qualify for the stimulus, it needs to be filed before August 15th. This is very important if 2020 was a low-income year (as it was for many individuals) sandwiched between higher income years in 2019 and 2021.

The final opportunity to qualify is based on 2021 income figures reported on your taxes next year. If the 2021 income qualifies, then the stimulus will be paid as a refundable tax credit that can increase your tax refund or decrease your taxes owed.

The takeaways here are to be mindful of when you file your 2020 income taxes if they are lower than 2019, or to be careful about taking income in 2021 if you are close to the phaseout range. Some income can't be avoided, but sometimes there are options at the margins like holding onto unrealized gains rather than selling and realizing those gains or delaying Social Security benefits if this is the year you planned to start. Even though this is a 2021 tax credit, the IRS won't be asking for the stimulus money to be paid back if you qualified in 2019 or 2020 but will make too much in 2021. This is an area where a little tax planning could go a long way.

Tax Move to Consider: If your 2020 income will be below the phaseout ranges but 2021 will likely be higher, file your 2020 taxes by August 15, 2021. If 2021 income will be close to or within the phaseouts, try to limit income to maximize the rebates.

Temporary Expansion of the Child Tax Credit

It's been quite the ride for the Child Tax Credit these past few years. In 2018 the Trump tax cuts doubled the credit from $1,000 to $2,000 per eligible child aged 16 and younger. Under the American Rescue Plan the credit gets another bump for one year only. The new credit amount is $3,000 for most children and $3,600 for children under the age of six. This one-year expansion of the credit also makes teenagers turning 17 in 2021 eligible for the credit. However, it is scheduled to go back to age 16 and under in 2022.

The credit has always been subject to a phaseout for higher-income taxpayers, starting at $400,000 for Married Filing Joint taxpayers and $200,000 for single filers. This phaseout reduces the credit by $50 for every $1,000 of income over the lower income limit. The upper limit is then determined by the base credit amount which is determined by how many children are eligible and their ages.

However, this one-year expansion of the child tax credit adds a second layer of phaseouts for the new higher amounts. This second layer is $150,000 for joint filers, $112,500 for Head of Household filers, and $75,000 for everyone else. Once again, the credit is reduced by $50 for every $1,000 of income above the income threshold, but only down to $2,000 per child. For example, a married couple with one two-year-old child and $200,000 of income would be above the first income phaseout but not the second one. Therefore, their child tax credit would be $2,000 rather than $3,600.

Another change for this credit is that it is fully refundable for 2021, meaning that the credit won't just bring a taxpayer's tax bill down to zero, but will add to their refund even if they didn't have any Federal income tax liability. Previously, $1,400 of the credit was refundable, not the entire amount.

To speed up the process of getting these refundable tax credits to families before they file their 2021 tax returns, half of the credit is scheduled to be paid in advance monthly from July to December 2021. The IRS plans on using data from 2020 income tax returns to calculate which children will be claimed in 2021 and what their ages will be this year. For families under both income phaseout ranges in 2020, they will receive monthly payments of $250 for their children ages 6-17 and $300 for ages 1-5. (Children born in 2021 won't receive monthly payments because they weren't claimed on the 2020 taxes. However, they are still eligible for the credit on the 2021 tax return.)

Unlike the recovery rebates (Biden Bucks), these prepaid tax credits are subject to clawbacks. So, if your 2021 income will be higher and reduce or eliminate the child tax credits, you will be asked to pay back some or all of these prepaid credits with your 2021 taxes. This may get especially tricky for unmarried parents who take turns claiming the kids every other year. Good luck working that out!

As mentioned before, the expansion of the credit is only for one year, unless Congress changes their mind and makes it a permanent part of the tax code. This is a possibility as many pundits expect a tax bill to be passed later this year. We'll be keeping an eye on this as the year unfolds.

Tax Move to Consider: If you have children eligible for the Child Tax Credit, try to avoid the phaseout ranges if possible. They effectively add a 5% surtax to your regular tax bracket.

Temporary Enhancements to the Premium Assistance Tax Credit

The American Rescue Plan also expanded the availability of Premium Assistance Tax Credits for those who buy their health insurance through their state-run health insurance exchange. In English, this means those on Obamacare should get larger credits to help with their health insurance premiums. Some taxpayers who get their insurance through the exchange but usually make too much money to qualify for credits will now qualify for some assistance in 2021 and 2022. If you get your health insurance through the exchange, a phone call to your health insurance agent is in order to apply for tax credits that may lower your monthly premiums.

For those who received Premium Assistance Tax Credits (PATC) in 2020 and had to pay back some of those credits when 2020 income was tallied on your income taxes, the American Rescue Plan has some good news for you. For the 2020 tax year only, the clawback feature of PATC has been suspended. This means if your 2020 income was higher than you anticipated when you signed up for health insurance in the fall of 2019, your excess tax credits don't need to be paid back when you file your 2020 taxes! If you haven't filed your 2020 taxes yet, you can simply skip Form 8962 to reconcile your tax credits if you were overpaid. If you have already filed and repaid those credits, the IRS will automatically refund that portion of your taxes.

Tax Move to Consider: Contact your health insurance agent to see if you qualify for additional Premium Assistance Tax Credits. Be cautious about adding income such as Roth conversions if they will negatively affect your Premium Assistance Tax Credits.

Tax-Free Student Loan Forgiveness through 2025

Although no student loans were forgiven in the American Rescue Plan, the act alludes to the prospect of student loan debt being forgiven in the future. The bill makes the forgiveness of student debt excluded from income from 2021 to 2025. Obviously, this is only relevant if the President or Congress forgives student loan debt in the future. Still, by adding this provision taxpayers won't have to worry about the tax consequences if that event comes to pass.

Tax Move to Consider: Hold off on paying off student loans until the process plays out to determine who may be eligible for possible student loan forgiveness in the future. If you have Federal student loans, do not refinance all of them with a private lender which may make your loans not eligible for forgiveness.

Required Minimum Distributions are back for 2021

After taking a year off from RMDs in 2020 due to the CARES Act, some thought this stimulus package might grant another of optional IRA distributions. This provision did not make the final cut and IRA owners 72 and older are required to take a minimum amount out of their accounts to be taxed in 2021.

Final Thoughts

As with any change in national leadership, this administration and Congress has a lot of ideas that they would like to implement. This bill, although large in size, is just the beginning of what they hope to accomplish. The temporary nature of the expanded child tax credits and premium assistance tax credits along with the tax-free treatment of student loan forgiveness leaves us with some unanswered questions, but also with an idea of what may be coming in the future. As future tax provisions are implemented, we'll be here to help you understand them and plan your taxes accordingly.

"In playing ball, and in life, a person occasionally gets the opportunity to do something great. When that time comes, only two things matter: being prepared to seize the moment and having the courage to take your best swing."

--Hank Aaron (1934-2021)
American professional baseball player and member of the Baseball Hall of Fame