

# June 2021 Newsletter

## Changes to the Child Tax Credit (CTC), Advance Payments for 2021

A recently passed law changes the amount of the Child Tax Credit and how it is implemented, impacting millions of taxpayers. Some amount of the credit will be paid to eligible taxpayers monthly in advance, starting July 15<sup>th</sup>, 2021. If you usually claim the Child Tax Credit, these payments **will** decrease your refund or increase the amount due on your 2021 tax return. All taxpayers who are eligible to receive the credit are auto enrolled into receiving the advance payments. Depending on your own tax situation, you may want to opt-out. Please read on for more details.

### What is the Child Tax Credit?

The Child Tax Credit is typically a \$2,000 tax credit that parents receive for each child they claim on their tax return aged 16 and under. Tax **credits** are different (and more beneficial) than tax **deductions** in that they reduce the tax you owe (increase your refund) dollar for dollar.

For example, the tax benefit of a 1\$ **deduction** is  $1 \times (\text{your tax rate}) = \text{net tax benefit}$ . If your tax rate is 22%, the tax benefit of a \$1 deduction would be 22 cents. Tax **credits**, as mentioned above, give you a dollar-for-dollar tax benefit. Following our example, while a \$1 tax deduction yields a taxpayer 22 cents, a \$1 tax credit yields 1\$. This is why the CTC is such an important credit for taxpayers, as it's an actual \$2,000 benefit per child on a parent's tax return.

### How is the Child Tax Credit Changing for 2021?

In recent years, the normal Child Tax Credit has been \$2,000 for each child aged 16 or under. As part of the American Rescue Plan, which was passed by congress and signed into law in March of 2021, the Child Tax Credit was enhanced. For Individuals earning less than \$75,000 per year and married couples earning less than \$150,000 per year, the credit is now worth \$3,600 for children under age 6 and \$3,000 for children aged 6-17. This enhanced credit amount phases out once an individual's income is above \$95,000 or a married couple's income is above \$170,000. For taxpayers above these upper thresholds, the base unenhanced \$2,000 credit is still available unless an individual's income is above \$200,000 or a married couple's income is above \$400,000, depending on the number of children. Please see the charts below for an explanation of who is eligible for how much Child Tax Credit.

Single Income	Available Credit
<\$75,000	Full Enhanced Credit
\$75,000-95,000	Partial Enhanced Credit
>\$95,000	No Enhanced Credit; Base \$2,000 credit available
>\$200,000	Base \$2,000 credit begins to decrease

<b>Married</b>	
<b>Income</b>	<b>Available Credit</b>
<\$150,000	Full Enhanced Credit
\$150,000-170,000	Partial Enhanced Credit
>\$170,000	No Enhanced Credit; Base \$2,000 credit available
>\$400,000	Base \$2,000 credit begins to decrease

A change was also made to how the CTC is implemented, changing how **all** taxpayers receive these credit dollars. Traditionally, the full credit is taken on a taxpayer's year-end tax return and reduces the amount of total tax owed. With this law change, **the IRS will now send out 50% of your 2021 estimated Child Tax Credit in advance, monthly installments starting July 15<sup>th</sup>. The other 50% of the credit will be taken on the year-end tax return.** I'll walk through an example below to illustrate how this will work:

*Example: A Married Filing Joint Couple has a combined annual income of \$130,000 and have two kids, aged 5 and 11.*

*Here, given the ages of the children and the household income, this family will have an estimated Child Tax Credit for 2021 of \$6,600. (1 Child under age 6 = \$3,600; 1 Child aged 6-17 = \$3,000; \$3,000+\$3,600= \$6,600.)*

*The IRS will send out \$3,300 ( $\$6,600 \times 50\%$ ) in equal monthly installments through the end of the year, and the remaining \$3,300 will be claimed on the taxpayer's year-end tax return. This household will now receive monthly payments of \$550 ( $\$3,300/6$ ) from July through December of 2021. The household will now only be able to reduce tax owed on their year-end return by \$3,300, since half was paid in advance during the year.*

The IRS estimates the amount of your Child Tax Credit based on the age and number of children you claimed on your prior year tax return. If you had a child in 2021, you will not receive any advance payments relating to that child as the IRS essentially doesn't know that you had the child. You will instead take the full credit amount for that child on your year-end return.

If you are a non-filer or have not filed your tax returns for a few recent years, you will need to file those returns for the IRS to issue you any advance payments of this credit.

As of this writing, the enhanced credit and the advanced payment of it only impacts your 2021 taxes.

## **Planning for Changes to the Child Tax Credit**

The IRS is auto enrolling **ALL** taxpayers who received the Child Tax Credit in the prior year into receiving monthly, advance payments. If you received the child tax credit last year, you will receive advance payments of your 2021 Child Tax Credit if you do nothing.

For taxpayers who do not want to receive these advance payments, the IRS allows you to opt-out. Taxpayers who opt out will still receive the full credit they are entitled to and will receive the full value of their credit on the year-end return. Opting out only opts out of the monthly, advance payments.

You're thinking, "should I opt-out? Should I leave it alone and receive the monthly advance payments?" In my opinion, there are many reasons to opt out and only a few reasons to receive the advanced payments.

**You should receive payments if you:**

- are experiencing financial hardship and the advance payments will provide relief
- have a comprehensive tax plan and would prefer to receive the money in advance instead of at the end of the year

**You should opt-out of the payments if you:**

- have a dependent that you claim every other year due to a divorce or separation agreement
- have a comprehensive tax plan and are comfortable with your typical balance due or refund amount in recent years
- want to avoid paying money received in advance back to the IRS in the event of an increase in income or change in dependent status
- don't want to deal with keeping track of the amount of payments received, which you'll need to reconcile on your year-end tax return, similar to last year's stimulus payments
- prefer to receive a larger refund at tax time to pay for vacations, property taxes, etc..

**Repayment of excess advance payments**

In a few of the points above, not opting out of the advance payments may cause you to owe when you file your year-end tax return. If you claimed a child last year but will not claim that child again this year, you may have to pay back 100% of the advance payments received. If your household income goes up you may receive more in advance payments than you are entitled to, causing you to pay some amount back at tax time. Generally, if you have a fine-tuned tax situation, and you typically get a refund, the advance payments will cause your refund to be lower on your tax return, and you may even owe money instead of receiving a refund. This situation is explained in the example below.

*Example: A Married Filing Joint Couple has a combined annual income of \$130,000 and have two children, aged 5 and 11. They typically get a \$500 refund and choose not to opt-out of receiving advanced CTC payments.*

*Here, given the ages of the children and the household income, this family will have an estimated Child Tax Credit for 2021 of \$6,600. (1 Child under age 6 = \$3,600; 1 Child aged 6-17 = \$3,000; \$3,000+\$3,600= \$6,600.)*

*The IRS will send out \$3,300 ( $\$6,600 \times 50\%$ ) in equal monthly installments through the end of the year, and the remaining \$3,300 will be claimed on the taxpayer's year-end tax return. This household will now receive monthly payments of \$550 ( $\$3,300/6$ ) from July through December of 2021. The household will now only be able to reduce tax owed on their year-end return by \$3,300, since half was paid in advance during the year.*

The couple typically receives a total of \$4,000 in child tax credits on their year-end tax return, already included in their \$500 refund. Now, with the advance payments, they will only receive total credits on their year-end return of \$3,300. Since their total credits on the year-end return decreased by \$700, they would now owe \$200 at tax time. Granted, they would receive \$3,300 during the year, so it is still a net tax benefit, but they may not expect or be prepared to owe at tax time. The more dependents a taxpayer has, the more exaggerated this phenomenon becomes.

On the flipside, if the couple chose to opt-out of the advance payments, they would receive no money during the year, and instead their year-end refund would be \$3,100. They would not owe anything at tax time and would just have a larger refund on their year-end return. See the charts below for a visual explanation of the opt-in or opt-out decision for this situation, and its impact on a taxpayer's refund at tax time.

2021 Receive Advance Payments	
Tax Owed	(3,500.00)
Child Tax Credit taken on Tax Return	3,300.00
Refund (Balance Due) on Tax Return	(200.00)
Advance Payments Received	3,300.00
Total dollars received	3,100.00

Recent Previous Years	
Tax Owed	(3,500.00)
Child Tax Credit	4,000.00
Refund	500.00

2021 Opt-out of Advance Payments	
Tax Owed	(3,500.00)
Child Tax Credit taken on Tax Return	6,600.00
Refund (Balance Due) on Tax Return	3,100.00
Advance Payments Received	-
Total dollars received	3,100.00

It is important to note that whether you opt to receive the advance payments or not, you will end up with the same total dollars. The only thing that will change is that how much of your total refund dollars will be received in advance vs. on your end of year tax return.

### Choosing to opt-out of the advance payments

If you want to receive the advance payments, its easy, just do nothing. If you wish to opt-out, the IRS has an opt-out portal at <https://www.irs.gov/credits-deductions/advance-child-tax-credit-payments-in-2021>. **If you are married, you and your spouse will both have to log into the portal and opt-out. If only one spouse opts out, the other spouse will still receive payments for their portion of the advance payments.** Please consult with your tax advisor to determine what the best course of action is for your specific tax situation.