



Aurora Financial Services Inc

Tax-Saving Tips

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PPP Extended—Act Fast or Miss Out

This is likely it—your last chance to obtain first- and second-draw Paycheck Protection Program (PPP) monies.

A new law, the PPP Extension Act of 2021, extends the expiration date to the later of May 31 or when the money runs out. Note the phrase “when the money runs out,” and be forewarned that this can happen within weeks. So don’t procrastinate—not even for one day.

If you qualify for the first-draw PPP money, complete your application now. The money is going to run out fast—and once it’s gone, so is the PPP. Legislatively, the new round for the PPP ends on May 31. The clock ticks.

You qualify for the PPP if any of the following are true:

- You file your taxes on Schedule C of your tax return. Businesses that file on Schedule C include independent contractors, single-member LLCs, proprietorships, and statutory employees, such as life insurance salespeople.
- You file your taxes on Schedule F (ranchers and farmers).

- You are a general partner in a partnership, but the partnership asks for and receives the money based on your and the other partners’ combined self-employment incomes, as adjusted.
- You operate as an S corporation.
- You operate as a C corporation.
- You are the only worker in the business.
- You have employees whom you pay on a W-2.

If you qualify, you want the PPP. It’s a much-needed, tax-free cash infusion. It’s called a loan, but it’s not. You have to repay loans. The PPP does not have to be repaid—it’s forgiven.

Plus, expenses paid with this forgiven PPP loan are tax-deductible.

Double Benefits: Claiming Both the ERC and Tax-Free PPP

First, say thanks to the Consolidated Appropriations Act, 2021 (CAA), enacted December 27, 2020. It opened the door (retroactively and going forward)

for PPP participants to also claim the employee retention credit (ERC).

Reminder. Tax credits are the best. They usually reduce taxes dollar-for-dollar.

(The ERC is not quite as good as the usual tax credit, because you increase taxable income by the amount of the credit. But it's still good—very good.)

The CARES Act, enacted on March 27, 2020, created the PPP money, but it prohibited you from getting both PPP money and tax credits from the ERC; you had to choose one benefit or the other. Now, thanks to the new December law, you can have both tax-free PPP money and tax credits from the ERC.

And perhaps the best news of all comes from the IRS in its recently released, business-friendly guidance on how the rules work when you want to claim both PPP and ERC benefits.

How the Law Changed

The CAA made four important changes retroactive to 2020:

1. You may now qualify (yes, retroactively) to claim the ERC for 2020 wages even though you had a 2020 PPP loan.
2. You may not claim the ERC on PPP wages used for PPP loan forgiveness.
3. You can elect not to claim the ERC, so as to increase your tax-free PPP monies.
4. If your lender denies your PPP loan forgiveness, you can claim the ERC for the qualified wages even when you made the election not to claim the ERC for those wages.

Congress made the changes retroactive to March 13, 2020, allowing you to now amend your 2020 payroll

tax returns to claim the employee tax credits for which you are eligible.

You likely hadn't thought of amending payroll tax returns, because it's not often done. But you have the three-year statute of limitations for amending payroll taxes just as you have it for your income tax returns.

Married, Filing Separately, May Be the Tax Year 2020 Strategy

If you are married, most likely you've always filed a joint tax return with your spouse.

Most of the time, a joint return shows less overall tax than two separate tax returns do, because the married-filing-separately status has many tax disadvantages.

Fast-forward to the 2020 tax filing season, however—and nothing is as it was.

This year, four tax provisions will be key to determining whether you'll be better off filing a joint tax return or separate tax returns for tax year 2020:

- Tax-free unemployment
- Recovery rebate, round 1
- Recovery rebate, round 2
- Recovery rebate, round 3

Tax-Free Unemployment

The American Rescue Plan Act of 2021, which was signed into law on March 11, 2021, excludes from tax the first \$10,200 of 2020 unemployment benefits paid to an individual with 2020 modified adjusted gross income (MAGI) of less than \$150,000.

Recovery Rebate, Round 1

The recovery rebate, round 1, is a refundable tax credit on the 2020 tax return, equal to

- \$1,200 (\$2,400 on a joint return), plus
- \$500 for each dependent under age 17.

Your credit decreases by 5 percent of the amount your adjusted gross income (AGI) exceeds

- \$150,000 if married, filing a joint return,
- \$112,500 if head of household, or
- \$75,000 if single, or if married, filing separately.

The IRS gave you an advance payment of this credit based on either your 2018 or 2019 AGI and dependents. And now the IRS looks at your 2020 tax return and does the following:

- Smiles on you if the tax credit based on your 2020 tax return exceeds the advance payment. What do we mean by “smiles on you”? You get the additional amount as a refundable tax credit.
- Smiles on you (again!) if your actual credit is less than the advance payment. You keep the money. You don’t have to pay back any excess received.

Recovery Rebate, Round 2

This is a refundable tax credit on the 2020 tax return, equal to

- \$600 (\$1,200 on a joint return), plus

- \$600 for each dependent under age 17.

Your credit decreases by 5 percent of the amount your AGI exceeds

- \$150,000 if married, filing jointly,
- \$112,500 if head of household, or
- \$75,000 if single, or if married, filing separately.

The IRS gave you an advance payment of this credit based on your 2019 AGI and dependents. And now the IRS looks at your 2020 tax return and

- Smiles on you if the tax credit based on your 2020 tax return exceeds the advance payment. What do we mean by smiles on you? Once again, you get the additional amount as a refundable tax credit.
- Smiles on you (again!) if your actual credit is less than the advance payment. You keep the money. You don’t have to pay back any excess received.

Recovery Rebate, Round 3

This is a refundable tax credit on the 2021 tax return, equal to

- \$1,400 (\$2,800 on a joint return), plus
- \$1,400 for each dependent, regardless of age.

Your credit phases out over the following AGI ranges:

- \$150,000 to \$160,000 if married, filing jointly,
- \$112,500 to \$120,000 if head of household, or

- \$75,000 to \$80,000 if single, or if married, filing separately.

The IRS will give you an advance payment of this credit based on your 2019 or 2020 AGI and dependents. If your first advance payment used your 2019 return information, then the IRS will send an additional payment based on your 2020 tax return if the IRS processes your 2020 tax return by August 15, 2021.

You then reconcile your advance payment(s) on your 2021 tax return:

- If your actual credit amount exceeds the advance payment, you get the difference as a refundable credit.
- If your actual credit is less than the advance payment, you keep what you have. You don't have to pay back the excess benefit.

Why Separate Returns Could Be Better

There are two main reasons you may have net lower federal tax with separate returns versus a joint return.

First, if your MAGI is \$150,000 or more on a joint return, but the spouse who received the unemployment compensation earns under \$150,000 on a separate return, then that spouse can take the full exclusion up to \$10,200 (except possibly in a community property state).

Second, if one spouse has AGI of \$75,000 or less, but your joint AGI is over \$150,000, then that spouse can claim the dependents and get all the available round 1 and round 2 credits on the 2020 tax return as well as the entire round 3 advance payment.

When considering the above, keep two important notes in mind:

1. For a couple that got joint advance payment(s), the law says you allocate 50 percent of the payment to each spouse. The higher-earning spouse doesn't pay back any of his or her allocated advance payment, while the lower-income spouse will get the difference as a refundable tax credit.
2. Married taxpayers who agree how to allocate dependents on separate returns do not have to use the "tiebreaker" rules and can choose who claims which dependents.

Important note. You may lose other deductions and credits on a separate return. The only way to know which is better in light of these temporary provisions is to run your tax returns both ways and see which puts you ahead. For example, separate returns can change your health insurance premium tax credit and perhaps some non-tax items such as your Medicare premiums.

ARPA Adds Cash to the Child Tax Credit (2021 Only)

For the 2021 tax year only, the American Rescue Plan Act of 2021 (ARPA) makes big, taxpayer-friendly changes to the federal income tax child tax credit (CTC).

Here's what you need to know, starting with some necessary background information.

CTC Basics

For 2018-2020 and 2022-2025, the maximum annual CTC is \$2,000 per *qualifying child*.

A qualifying child is an **under-age-17** child who could be claimed as your dependent for the year. Basically, that means the child lived with you for over half the

year; did not provide more than half of his or her own support; and is a U.S. citizen, U.S. national, or U.S. resident.

The maximum \$2,000 CTC is phased out (reduced) if your modified adjusted gross income (MAGI) for the year exceeds \$200,000, or \$400,000 for a married joint-filing couple. The credit is phased out by \$50 per \$1,000 (or fraction of \$1,000) of MAGI in excess of the applicable phaseout threshold.

For 2018-2020 and 2022-2025, the CTC is partially refundable. You can collect the refundable amount even if you have no federal income tax liability for the year. So, the refundable amount is free money. The refundable amount generally equals 15 percent of your earned income above \$2,500.

An alternative formula for determining the refundable amount applies if you have three or more qualifying children. In any case, the maximum refundable amount for 2018-2020 and 2022-2025 is limited to \$1,400 per qualifying child. (If you have a 2020 tax liability, the CTC can offset up to \$2,000.)

More Generous CTC Rules for 2021

For your 2021 tax year only, ARPA makes the following taxpayer-friendly changes.

Qualifying Children Can Be Up to 17 Years Old

The definition of a qualifying child is broadened to include children who are **age 17 or younger** as of December 31, 2021.

Bigger Maximum CTC with Separate Phaseout Rule for the Increase

ARPA increased the maximum CTC to \$3,000 per qualifying child, or \$3,600 for a qualifying child who is age 5 or younger as of December 31, 2021. But the increased 2021 credit amounts are subject to two phaseout rules:

1. The increased CTC amount—\$1,000 or \$1,600, whichever applies—is phased out for

single taxpayers with MAGI above \$75,000, for heads of household with MAGI above \$112,500, and for married jointly filing couples with MAGI above \$150,000. The increased amount is phased out by \$50 per \$1,000 (or fraction of \$1,000) of MAGI in excess of the applicable phaseout threshold.

2. The “regular” \$2,000 CTC amount is subject to the “regular” phaseout rule explained earlier.

Key point. If you’re not eligible for the increased CTC amount for 2021 because your income is too high, you can still claim the regular CTC of up to \$2,000, subject to the regular phaseout rule.

CTC Is Fully Refundable for Most Folks

For the 2021 tax year, the CTC is fully refundable if you (or, if married, you and your jointly filing spouse) have a principal residence in the U.S. for more than half the year. If you are a member of the U.S. Armed Forces who is stationed outside the U.S. while serving on extended active duty, you’re treated as having a principal residence in the U.S.

For 2021, the CTC is fully refundable even if you have no earned income for the year. The MAGI phaseout rules explained earlier apply in calculating your allowable, fully refundable CTC for 2021.

IRS Will Make Advance CTC Payments (We Hope)

Another ARPA provision directs the IRS to establish a program to make monthly advance payments of CTCs (generally via direct deposits).

Such advance payments will equal 50 percent of the IRS’s estimate of your allowable CTC for 2021. The advance payments will be made in the form of equal monthly installments from July through December 2021. To estimate your advance CTC payments, the IRS will look at the information shown on your 2020 Form 1040 (or on your 2019 return if you have not yet filed your 2020 return).