

**DESCRIPTION OF THE BUDGET RECONCILIATION
LEGISLATIVE RECOMMENDATIONS RELATING
TO PROMOTING ECONOMIC SECURITY**

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INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of the Budget Reconciliation Legislative Recommendations Relating to Promoting Economic Security on February 10, 2021. This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of the Budget Reconciliation Legislative Recommendations Relating to Promoting Economic Security* (JCX-3-21), February 8, 2021. This document can also be found on the Joint Committee on Taxation website at www.jct.gov. All section references herein are to the Internal Revenue Code of 1986, as amended (herein “Code”), unless otherwise stated.

GENERAL BACKGROUND

A. Present Law

The following descriptions of present law are relevant to the income tax credit proposals in Part 1, Part 2, Part 3, Part 4, and Part 7 of the bill.

Individual refundable income tax credits

An individual may reduce his or her income tax liability by available income tax credits. In some instances, a credit is wholly or partially refundable. That is, if the amount of a taxpayer's refundable income tax credits exceeds the taxpayer's income tax liability (net of other nonrefundable credits), these credits create an overpayment, which may generate a refund or be credited against any other internal revenue tax liability.² A refund or credit is authorized for a taxable year only if an overpayment exists, that is, if the amounts paid or deemed paid exceed the tax liability for that year.³

Dependents

Under section 152 of the Code, a taxpayer's dependents include both the taxpayer's qualifying children and the taxpayer's qualifying relatives.⁴ A dependent must be a citizen, national,⁵ or resident of the United States or of a country contiguous to the United States (*i.e.*, Canada or Mexico).⁶

Generally, a qualifying child of a taxpayer is any individual who (1) meets the age test,⁷ and (2) is the taxpayer's son, daughter, stepson, stepdaughter, adopted child, foster child, brother, sister, stepbrother, stepsister, or a descendant of any such individual.⁸ The individual also (3) must share the same principal place of abode as the taxpayer for more than one-half of the taxable year,⁹ (4) may not have provided over one-half of his or her own support for the taxable

² See secs. 37, 6401, 6402.

³ See sec. 6402(a).

⁴ Sec. 152.

⁵ Non-citizen U.S. nationals include (i) individuals born in American Samoa or (ii) certain individuals born in the Commonwealth of the Northern Mariana Islands who have chosen to be U.S. nationals instead of U.S. citizens. See 8 U.S.C. sec. 1408; *Tuaua v. United States*, 788 F.3d 300 (D.C. Cir. 2015); 48 U.S.C. sec. 1801 note, Article III.

⁶ Sec. 152(b)(3). There are special rules for certain adopted children.

⁷ Sec. 152(c)(1)(C), (c)(3).

⁸ Sec. 152(c)(1)(A), (c)(2), (f)(1).

⁹ Sec. 152(c)(1)(B).

year,¹⁰ and (5) may not file a joint return with a spouse.¹¹ The age test requires that the qualifying child must be either (1) under the age of 19 at the end of the calendar year, (2) under the age of 24 at the end of the calendar year and a full-time student,¹² or (3) permanently and totally disabled at any time during the calendar year, regardless of age.¹³

A qualifying relative of a taxpayer is any individual who (1) bears the appropriate relationship to the taxpayer,¹⁴ (2) has gross income for the taxable year that does not exceed the personal exemption amount,¹⁵ (3) receives over one-half of his or her support from the taxpayer,¹⁶ and (4) is not a qualifying child of the taxpayer.¹⁷ A qualifying relative who files a joint return with a spouse does not qualify as a dependent.¹⁸

For purposes of the definition of qualifying relative, an individual bears the appropriate relationship to the taxpayer if the individual is the taxpayer's lineal descendent or ancestor, brother, sister, aunt, uncle, niece, or nephew.¹⁹ Some relations by marriage also qualify, including stepmothers, stepfathers, stepbrothers, stepsisters, sons-in-law, daughters-in-law, fathers-in-law, mothers-in-law, brothers-in-law, and sisters-in-law. In addition, an individual bears the appropriate relationship if the individual has the same principal place of abode as the taxpayer and is a member of the taxpayer's household.²⁰

¹⁰ Sec. 152(c)(1)(D).

¹¹ Sec. 152(c)(1)(E); see also sec. 152(b)(2).

¹² Sec. 152(f)(2). To qualify as a full-time student, the individual must be, during five calendar months during a calendar year: (1) a full-time student at a school that has a regular teaching staff, course of study, and regular student body at the school, or (2) a student taking a full-time, on-farm training course given by a school described in (1), or a state, county, or local government.

¹³ An individual is permanently and totally disabled if he or she cannot engage in any substantial gainful activity because of a physical or mental condition and a doctor determines the condition has lasted or can be expected to last continuously for at least a year or can lead to death. Secs. 22(e)(3), 152(c)(3)(B).

¹⁴ Sec. 152(d)(1)(A), (d)(2).

¹⁵ Sec. 152(d)(1)(B). For taxable years beginning in 2018 through 2025, the reduction of the personal exemption amount to zero under section 151(d)(5) will not be taken into account in determining whether an individual is a qualifying relative under section 152(d)(1)(B). The exemption amount referenced in section 152(d)(1)(B) will be treated as \$4,150 (adjusted for inflation for taxable years beginning after 2018). See Prop. Treas. Reg. sec. 1.152-3(c)(3); Notice 2018-70, 2018-38 I.R.B. 441. The personal exemption amount for this purpose is \$4,300 for taxable years beginning in 2021. Rev. Proc. 2020-45, 2020-46 I.R.B. 1016.

¹⁶ Sec. 152(d)(1)(C).

¹⁷ Sec. 152(d)(1)(D).

¹⁸ Sec. 152(b)(2).

¹⁹ Sec. 152(d)(2).

²⁰ Sec. 152(d)(2)(H).

Qualifying child for purposes of the child tax credit

Generally, for purposes of the child tax credit, a qualifying child is a qualifying child under section 152 who is under the age of 17.²¹ Only a child who is a U.S. citizen, national, or resident may be a qualifying child; citizens of contiguous countries are ineligible under the child tax credit definition of qualifying child.

Identification number requirements

Many provisions of the Code require a taxpayer to include either a TIN (‘‘TIN’’) or Social Security Number (‘‘SSN’’) for specified individuals. A taxpayer is required to include a TIN when filing a U.S. tax return. Generally, an individual taxpayer’s TIN is his or her SSN.²²

SSNs are issued to United States citizens and nationals. In addition, noncitizens may be eligible to receive SSNs. The Social Security Administration (‘‘SSA’’) is authorized to issue an SSN to a noncitizen for certain purposes including (1) for purposes relating to the lawful admission for employment in the United States, or (2) for claiming a benefit financed in whole or in part from Federal funds.²³

An individual who has a U.S. tax filing obligation but who is not eligible to receive an SSN must apply to the Internal Revenue Service (‘‘IRS’’) for an individual taxpayer identification number (‘‘ITIN’’) for use in connection with the individual’s tax filing obligation.²⁴ An individual who is eligible to receive an SSN may not apply for an ITIN.²⁵ An ITIN does not provide eligibility to work in the United States or allow the ITIN holder to claim Social Security benefits.

The taxation of the U.S. territories

Citizens of the United States are generally subject to Federal income tax on their U.S. and foreign income regardless of whether they live in a State, a foreign country, or a U.S. territory. Residents of the five U.S. territories²⁶ are generally subject to the Federal income tax system based on their status as U.S. citizens or residents of the territories, with certain special rules for determining residence and source of income specific to the territory. Broadly, a bona fide

²¹ Sec. 24(c). The age requirement must be met at the close of the taxable year. See 2020 Instructions 1040, p.18.

²² Sec. 6109(a); Treas. Reg. sec. 301.6109-1(a)(1)(ii)(A).

²³ See Section 205(c)(2)(B)(i)(I), (II) of the Social Security Act, codified as 42 U.S.C. sec. 405(c)(2)(B)(i)(I), (II). The SSA also is authorized to issue SSNs to individuals who could have been but were not assigned SSNs for either of these purposes, if certain other conditions are met. Section 205(c)(2)(B)(i)(III) of the Social Security Act, codified as 42 U.S.C. sec. 405(c)(2)(B)(i)(III).

²⁴ Treas. Reg. Sec. 301.6109-1(a)(1)(ii)(B), (d)(3).

²⁵ Treas. Reg. Sec. 301.6109-1(d)(3)(ii).

²⁶ The Code refers to the territories are referred to as ‘‘possessions.’’

individual resident of a territory is exempt from U.S. tax on income derived from sources within that territory but is subject to U.S. tax on U.S.-source and non-territory-source income.²⁷ A bona fide resident of a territory for a taxable year is generally an individual (1) who is present for at least 183 days during the taxable year in the territory, and (2) who does not have either a tax home outside the territory or a closer connection to the United States or a foreign country than to the territory.²⁸

The application of the Federal tax rules to the territories varies from one territory to another. Three territories—Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands—are referred to as mirror Code territories because the Code serves as the internal tax law of those territories (substituting the particular territory for the United States wherever the Code refers to the United States).²⁹ Thus, for example, there is a mirror Code version of the earned income tax credit under the internal revenue laws of each mirror Code territory. A resident of one of those territories generally files a single tax return only with the territory of which the individual is a resident, and not with the United States.³⁰

American Samoa and Puerto Rico, by contrast, are non-mirror Code territories. These two territories have their own internal tax laws, and a resident of either American Samoa or Puerto Rico may be required to file income tax returns with both their territory of residence and the United States.

The non-mirror Code territories may offer individual refundable income tax credits to their residents under their own tax laws. In addition, residents of the territories may be entitled to individual refundable income tax credits from the U.S. Treasury under the Code.

²⁷ See secs. 932, 933, and 937; see also former sec. 935 (1986), which remains in effect pursuant to the Tax Reform Act of 1986, Pub. L. No. 99-514, sec. 1277(b), October 22, 1986; 48 U.S.C. sec. 1801 note, sec. 601.

²⁸ Sec. 937.

²⁹ 48 U.S.C. sec. 1397 (U.S. Virgin Islands); 48 U.S.C. sec. 1421i (Guam); 48 U.S.C. 1801 note, sec. 601 (Commonwealth of the Northern Mariana Islands).

³⁰ Sec. 932 and former sec. 935.

**BUDGET RECONCILIATION LEGISLATIVE RECOMMENDATIONS
RELATING TO PROMOTING ECONOMIC SECURITY**

SUBTITLE G—PROMOTING ECONOMIC SECURITY

PART I—2021 RECOVERY REBATES TO INDIVIDUALS

A. 2021 Recovery Rebates to Individuals

Present Law

In response to the economic and health crises in 2020, Congress enacted two refundable income tax credits for individuals that could be advanced to eligible individuals. Each credit is described below.

2020 CARES Act recovery rebate

The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) provides a one-year refundable income tax credit for 2020, referred to as the 2020 recovery rebate.³¹ The credit is referred to as a rebate because it includes rules, described below, under which the Secretary of the Treasury (herein “Secretary”) makes an advance payment to a taxpayer for the amount of the credit (determined based on prior year filing characteristics or other information) before the taxpayer files a 2020 Federal income tax return.³²

An eligible individual is allowed a refundable income tax credit for the first taxable year beginning in 2020 equal to the sum of:

- \$1,200 (\$2,400 in the case of a joint return), and
- \$500 for each qualifying child of such individual.

³¹ Sec. 6428. Pub L. No. 116-136, sec. 2201, March 27, 2020. The CARES Act provision was subsequently amended by the Consolidated Appropriations Act, 2021 (“CAA”), and those amendments were given effect as if included in the CARES Act. See Pub. L. No. 116-260, Div. N, sec. 273, December 27, 2020. The CAA also added an additional 2020 recovery rebate (described below). *Id.*, sec. 272.

The two 2020 one-time rebates are similar in structure to a one-time rebate enacted in 2008 during a prior financial crisis, codified as section 6428 and later repealed. Economic Stimulus Act of 2008, Pub. L. No. 110-185, sec. 101, February 13, 2008. For a description of former section 6428, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 110th Congress* (JCS-1-09), March 2009, at 75-80.

³² In total, Treasury disbursed 161.9 million advance payments worth \$271.4 billion. IRS, “SOI Tax Stats - Coronavirus Aid, Relief, and Economic Security (CARES Act) Statistics, available at <https://www.irs.gov/statistics/soi-tax-stats-coronavirus-aid-relief-and-economic-security-act-cares-act-statistics> (last visited January 28, 2021).

An eligible individual is any individual other than (1) a nonresident alien, (2) an estate or trust, or (3) a dependent.³³ For these purposes, the child tax credit definition of a qualifying child applies (generally, a qualifying child as defined in section 152 who is under the age of 17).

The amount of the credit is phased out at a rate of five percent of the amount of adjusted gross income (“AGI”) above certain threshold amounts.³⁴ The threshold amount at which the credit begins phasing out is \$150,000 of AGI for joint filers and surviving spouses,³⁵ \$112,500 of AGI for head of household filers, and \$75,000 of AGI for all other filers.³⁶ Thus, the credit is fully phased out (*i.e.*, reduced to zero) for joint filers with no children at \$198,000 of AGI and for a single filer at \$99,000 of AGI.

Identification number requirement

No credit is allowed to an individual who does not include a valid identification number on the individual’s income tax return.³⁷ In the case of a joint return that does not include a valid identification number for either spouse, no credit is allowed. In the case of a joint return that includes a valid identification number for only one spouse, one-half of the joint return amount (\$1,200) is allowed.³⁸ A qualifying child may not be taken into account in determining the amount of the credit unless valid identification numbers for the taxpayer (or for at least one spouse in the case of a joint return) and the child are included on the return.

For purposes of this requirement, a valid identification number is an SSN as defined for purposes of the child tax credit,³⁹ which means that it must be issued by the SSA before the due date of the return (including extensions) to a citizen of the United States or pursuant to a provision of the Social Security Act relating to the lawful admission for employment in the

³³ Sec. 6428(d).

³⁴ Sec. 6428(c).

³⁵ Under the CARES Act, the phaseout threshold for surviving spouses was \$75,000 of AGI. The CAA amended the phaseout threshold for surviving spouses to be \$150,000 AGI.

³⁶ For example, a married couple that files jointly with two qualifying children and has an AGI below the phaseout range would be entitled to a recovery rebate credit of \$3,400 (\$2,400 + \$500 + \$500). If that couple’s AGI were \$175,000, the credit would be \$2,150 ($\$3,400 - .05 * (\$175,000 - \$150,000)$). The credit would be fully phased out for this taxpayer at \$218,000 of AGI.

³⁷ Sec. 6428(g).

³⁸ This valid identification number rule for joint returns was amended from the rule in the CARES Act by the CAA. Pub. L. No. 116-260, Div. N, sec. 273(a)(3). The CARES Act required that in the case of a joint return that does not include valid identification numbers for both spouses, no credit is allowed. Advance refunds were made on the basis of the CARES Act rule. Any additional amounts owed as a result of the amended rule can be claimed on a 2020 Federal income tax return.

³⁹ Sec. 24(h)(7).

United States.⁴⁰ Two exceptions to this requirement are provided. First, an adoption identification number is considered a valid identification number in the case of a qualifying child who is adopted or placed for adoption. Second, when a married couple files a joint return and at least one spouse was a member of the Armed Forces of the United States during the taxable year for which the return is filed, a full \$2,400 credit (subject to the income-based phaseout) is allowed even if the return includes a valid identification number for only one spouse.

The failure to provide a correct valid identification number is treated as a mathematical or clerical error. If a taxpayer claims an individual as a qualifying child, but based on the SSN provided the individual is too old to be a qualifying child, the provision of the SSN is treated as a mathematical or clerical error.⁴¹

Advance payments of the recovery rebate credit

A taxpayer may receive the recovery rebate credit as an advance refund in the form of a direct deposit to their bank account or as a check or prepaid debit card issued by the Secretary during calendar year 2020.⁴² The amount of the advance refund is computed in the same manner as the recovery rebate credit, except that the calculation is made on the basis of the income tax return filed for 2019 (instead of 2020), if available, or otherwise on the basis of the income tax return filed for 2018.⁴³ Accordingly, the advance refund amount generally is based on a taxpayer's filing status, number of qualifying children, and AGI as reported for 2019 or 2018. The Secretary is directed to issue advance refunds as rapidly as possible.

If a taxpayer has not filed an income tax return for 2019 or 2018, in administering the advance refund the Secretary may use information with respect to that taxpayer that is provided on a 2019 Form SSA-1099, Social Security Benefit Statement, or a 2019 Form RRB-1099, Social Security Equivalent Benefit Statement.⁴⁴ Recipients of these forms include Social Security retirement, disability, and survivor benefit recipients and railroad retirees who are not otherwise required to file a Federal income tax return. An individual in one of these categories is allowed a \$1,200 payment per person without the necessity of a return filing or other action.⁴⁵

Supplemental Security Income recipients and recipients of compensation and benefit payments from the Department of Veterans Affairs similarly are allowed \$1,200 per-person

⁴⁰ Sec. 205(c)(2)(B)(i)(I) (or that portion of subclause (III) that relates to subclause (I)) of the Social Security Act.

⁴¹ CARES Act, sec. 2201(b)(2).

⁴² The Treasury Department referred to these advance refunds as "economic impact payments."

⁴³ Sec. 6428(f).

⁴⁴ Sec. 6428(f)(5)(B).

⁴⁵ IRS, "Economic impact payments: what you need to know," IR-2020-61 (March 30, 2020), available at <https://www.irs.gov/newsroom/economic-impact-payments-what-you-need-to-know>.

payments automatically without the requirement of filing a return or taking other action.⁴⁶ Other taxpayers who do not have return-filing obligations in 2018 or 2019 could register to receive advance refunds using the “non-filer portal,” a web tool developed by the IRS; alternatively they could use a simplified Federal income tax return filing procedure for taxable year 2019.⁴⁷

In the case of any individual for which payment information is provided to the Secretary by the Commissioner of Social Security, the Railroad Retirement Board, or the Secretary of Veterans Affairs, the advance refund may be provided to the individual’s representative payee or fiduciary. The entire payment must be provided to the individual or used for the benefit of the individual. Enforcement provisions apply to prevent the misuse of the payment.

The amount of the recovery rebate credit allowed on a taxpayer’s 2020 income tax return (based on 2020 information) must be reduced by any advance refund received during 2020 (based on 2019 or 2018 information).⁴⁸ If the recovery rebate amount less the advance refund is a positive number (because, for example, a qualifying child was born to the taxpayer during 2020), the taxpayer is allowed that difference as a refundable credit against 2020 income tax liability. If, however, the result is negative (because, for example, the taxpayer’s AGI was higher in 2020 and was in the phaseout range), the taxpayer’s 2020 tax liability is not increased by that negative amount. In addition, a taxpayer that does not receive an advance refund may claim the recovery rebate amount on his or her 2020 income tax return. A taxpayer’s failure to reduce the recovery rebate amount by an advance refund is treated as a mathematical or clerical error. The advance refund is not includible in gross income.

The Secretary may not issue an advance refund after December 31, 2020. Within 15 days of distribution of the advance refund the Secretary is required to send a notice by mail to the

⁴⁶ IRS, “Supplemental Security Income recipients will receive automatic Economic Impact Payments,” IR-2020-73 (April 15, 2020), available at <https://www.irs.gov/newsroom/supplemental-security-income-recipients-will-receive-automatic-economic-impact-payments-step-follows-work-between-treasury-irs-social-security-administration>; IRS, “Veterans Affairs recipients will receive automatic Economic Impact Payments,” IR-2020-75 (April 17, 2020), available at <https://www.irs.gov/newsroom/veterans-affairs-recipients-will-receive-automatic-economic-impact-payments-step-follows-work-between-treasury-irs-va>.

⁴⁷ Rev. Proc. 2020-28, 2020-19 I.R.B. 792; IRS, “Treasury, IRS launch new tool to help non-filers register for Economic Impact Payments,” IR-2020-69 (April 10, 2020), available at <https://www.irs.gov/newsroom/treasury-irs-launch-new-tool-to-help-non-filers-register-for-economic-impact-payments>. Federal benefit recipients also could use the web tool for non-filers to enter information regarding any qualifying children to claim the additional \$500 per child payment as an advance refund. IRS, “IRS takes new steps to ensure people with children receive \$500 economic impact payments,” IR-2020-180 (August 14, 2020), available at <https://www.irs.gov/newsroom/irs-takes-new-steps-to-ensure-people-with-children-receive-500-economic-impact-payments>; IRS, “Register by Nov. 21 to get an Economic Impact Payment,” IR-2020-260, November 19, 2020, available at <https://www.irs.gov/newsroom/register-by-nov-21-to-get-an-economic-impact-payment-same-deadline-for-federal-beneficiaries-to-get-missed-500-per-child-payments>.

Under the CARES Act, the Secretary (or the Secretary’s delegate) is directed to conduct a public awareness campaign, in coordination with the Commissioner of Social Security and the heads of other relevant Federal agencies, to provide information regarding the availability of the recovery rebate credit, including information with respect to individuals who may not have filed a tax return for 2019 or 2018.

⁴⁸ Sec. 6428(e).

taxpayer's last known address that indicates the method by which the payment was made, the amount of such payment, and a phone number at the IRS to report any failure to receive such payment.

Treatment of the U.S. territories

The CARES Act directs the Secretary to make payments to each mirror Code territory (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) that relate to the cost (if any) of each territory's recovery rebate credit. The Secretary is further directed to make similar payments to each non-mirror Code territory (American Samoa and Puerto Rico).

The CARES Act requires the Secretary to pay to each mirror Code territory amounts equal to the aggregate amount of the credits allowable by reason of the CARES Act to that territory's residents against its income tax. Such amounts are determined by the Secretary based on information provided by the government of the respective territory.

To each non-mirror Code territory, the CARES Act requires the Secretary to pay amounts estimated by the Secretary as being equal to the aggregate credits that would have been allowed to residents of that territory if a mirror Code tax system had been in effect in that territory. Accordingly, the amount of each payment to a non-mirror Code territory is an estimate of the aggregate amount of the credits that would be allowed to the territory's residents if the credit provided by the CARES Act to U.S. residents were provided by the territory to its residents. This payment may not be made to any U.S. territory unless it has a plan that has been approved by the Secretary under which the territory will promptly distribute the payment to its residents.

No credit against U.S. income taxes is permitted under the CARES Act for any person to whom a credit is allowed against territory income taxes as a result of the CARES Act (for example, under that territory's mirror income tax). Similarly, no credit against U.S. income taxes is permitted for any person who is eligible for a payment under a non-mirror Code territory's plan for distributing to its residents the payment described above from the U.S. Treasury.

Exception from reduction or offset

Any refund allowed or made to an individual as an advance refund or as a similar payment to a resident of the U.S. territories is not subject to reduction or offset by other assessed Federal taxes that would otherwise be subject to levy or collection. In addition, these overpayments generally are not subject to offset for other taxes or non-tax debts owed to the Federal government or State governments.⁴⁹

⁴⁹ Prior to amendment, the CARES Act prohibited refunds from recovery rebate credits and advance refunds from being subject to reduction or offset. This prohibition was amended to only apply to advance refunds. See Pub. L. No. 116-260, Div. N, sec. 273(b)(1).

As an exception, an overpayment resulting from the advance refund is subject to the offset against overpayments of the amount of any past-due child support.⁵⁰ The term past-due child support means the amount of a delinquency, determined under a court order, or an order of an administrative process established under State law, for support and maintenance of a child (whether or not a minor), or of a child (whether or not a minor) and the parent with whom the child is living.⁵¹ The State must have notified the Secretary of the taxpayer's delinquency in order for the offset to apply. If the offset applies, the Secretary remits the offset amount to the State collecting such support and notifies the taxpayer of the remittance. The offset of past-due child support applies before any other reductions allowed by law and before the crediting of the overpayment to the taxpayer's future tax liability.

An overpayment resulting from the recovery rebate credit may be subject to claims by the taxpayer's creditors under applicable State law or Federal bankruptcy law.

2020 additional recovery rebate

In general

The Consolidated Appropriations Act, 2021 ("CAA"), provides an additional one-year refundable income tax credit for 2020, referred to as the additional 2020 recovery rebate.⁵² Like the first 2020 recovery rebate, the additional 2020 recovery rebate includes rules, described below, under which the Secretary makes an advance payment to a taxpayer for the amount of the credit (determined based on prior year filing characteristics or other information) before the taxpayer files a 2020 Federal income tax return. The additional 2020 recovery rebate has many of the same features as the first recovery rebate, with some modifications. These modifications are described below.

The additional 2020 recovery rebate is equal to the sum of:

- \$600 (\$1,200 in the case of a joint return), and
- \$600 for each qualifying child of such individual.⁵³

The phaseout thresholds and phaseout rate for the additional 2020 recovery rebate are the same as those of the first rebate, but because of the different amounts of the additional rebate, the

⁵⁰ See Sec. 6402(c). Following distribution of a significant share of the advance payments, the IRS announced that it would issue catch-up payments to individuals where such individual's portion of the payment had been diverted to pay their spouse's past-due child support. IRS, "50,000 spouses to get catch-up Economic Impact Payments," IR-2020-192, August 25, 2020, available at, <https://www.irs.gov/newsroom/irs-50000-spouses-to-get-catch-up-economic-impact-payments>; IRS, "Economic Impact Payment Information Center -- Topic D: Receiving My Payment," Q&A D2, available at, <https://www.irs.gov/newsroom/register-by-nov-21-to-get-an-economic-impact-payment-same-deadline-for-federal-beneficiaries-to-get-missed-500-per-child-payments>.

⁵¹ Sec. 464(c) of the Social Security Act, 42 U.S.C. sec. 664(c).

⁵² Pub. L. No. 116-260, Div. N, sec. 272, December 27, 2020.

⁵³ Sec. 6428A(a).

additional rebate is fully phased out at different levels of AGI. Thus, the additional 2020 recovery rebate is fully phased out (*i.e.*, reduced to zero) for joint filers with no children at \$174,000 of AGI and for a single filer at \$87,000 of AGI.

Identification number requirement

The identification number requirements for the additional 2020 recovery rebate follow those for the first recovery rebate (as amended by the CAA) and described above. Because the amounts of the additional 2020 recovery rebate differ from the first rebate, several rules are affected. In the case of a joint return that includes a valid identification number for only one spouse, a \$600 credit is allowed. In the case of a married couple filing a joint return where at least one spouse was a member of the Armed Forces of the United States during the taxable year for which the return is filed, a full \$1,200 credit (subject to the income-based phaseout) is allowed even if the return includes a valid identification number for only one spouse.

Advance payments of the 2020 additional recovery rebate

Just as with the first recovery rebate, many taxpayers receive the additional 2020 recovery rebate automatically as an advance refund in the form of a direct deposit to their bank account or as a check or prepaid debit card issued by the Secretary.⁵⁴ The amount of the additional advance refund is calculated on the basis of the income tax return filed for 2019, if available (rather than 2018 or 2019 as with the first advance refund).⁵⁵ Accordingly, the amount of the additional advance refund generally is based on a taxpayer's filing status, number of qualifying children, and AGI as reported for 2019. The Secretary is directed to issue additional advance refunds as rapidly as possible, and no additional advance refund is to be made or allowed after January 15, 2021.⁵⁶

If a taxpayer did not file an income tax return for 2019 at the time the Secretary makes a determination regarding payments, the Secretary may use information to administer the additional advance refund with respect to that taxpayer that is provided (1) in the case of a specified Social Security or Supplemental Security Income recipient, by the SSA, (2) in the case of a specified railroad retirement beneficiary, by the Railroad Retirement Board, and (3) in the

⁵⁴ Payments started during the last week of December 2020 and continued into January 2021. Direct deposit payments were issued to individuals with valid routing and account information on file with the IRS. IRS, "Questions and Answers about the Second Economic Impact Payment," available at <https://www.irs.gov/coronavirus/second-eip-faqs> (last visited January 24, 2021). As of January 8, 2021, over 100 million advance refunds had been direct deposited into eligible recipients' bank accounts. IRS, "IRS Statement -- Update on Economic Impact Payments," January 11, 2021, available at <https://www.irs.gov/newsroom/irs-statement-update-on-economic-impact-payments>.

The Treasury Department referred to these additional advance refunds as "second economic impact payments."

⁵⁵ Sec. 6428A(f).

⁵⁶ In the case of a mirror Code territory, the additional advance refund can be made or allowed until September 30, 2021.

case of a specified veterans beneficiary, by the Department of Veterans Affairs.⁵⁷ As with the first advance refund, payments for such specified individuals may be provided to the individual's representative payee or fiduciary.

For other individuals who did not have a return-filing obligation, the Secretary could utilize information provided by such individuals who either successfully registered for the first advance refund using the non-filer portal, or submitted a simplified Federal income tax return to receive the advance refund.⁵⁸

An individual who died before January 1, 2020, is not eligible to receive the additional advance refund. If a married couple files a joint return and one spouse died before January 1, 2020, the surviving spouse is allowed (subject to other requirements) a \$600 payment. No payment may be issued with respect to qualifying children of a taxpayer who died before January 1, 2020 (or, in the case of joint return, if both taxpayers died before January 1, 2020).

The rules regarding reconciliation of the second advance refund are the same as those for the first advance refund. The second advance refund similarly is not includible in gross income.

The Secretary is required to send a notice of the second advance refund that includes the same information as that required for the first advance refund. The Secretary is also required to carry out a public awareness campaign regarding the availability of the additional recovery rebate credit and the additional advance refund.

Treatment of the U.S. territories

The CAA directs the Secretary to make payments to each mirror Code territory that relate to the cost of each territory's additional recovery rebate and to make similar payments to each non-mirror Code territory. The same rules as those that applied to territory payments for the first recovery rebate apply to territory payments for the additional recovery rebate.

Exception from reduction or offset

As with the first recovery rebate, any refund payable as an advance refund or as a similar payment to a resident of the U.S. territories is not subject to reduction or offset by other assessed Federal taxes that would otherwise be subject to levy or collection, by other taxes, or by non-tax debts owed to the Federal government or State governments.

Unlike the first advance refund, the additional advance refund is not subject to reduction or offset for past-due child support. The additional advance refund also is not subject to transfer, assignment, execution, levy, attachment, garnishment, or other legal process, or the operation of any bankruptcy or insolvency law. The CAA directs the Secretary to encode payments that are

⁵⁷ Sec. 6428A(f)(5).

⁵⁸ IRS, "Treasury and IRS begin delivering second round of Economic Impact Payments to millions of Americans, IR-2020-280, December 29, 2020, available at <https://www.irs.gov/newsroom/treasury-and-irs-begin-delivering-second-round-of-economic-impact-payments-to-millions-of-americans>.

paid electronically with a unique identifier that allows the financial institution maintaining the account to identify the payment as protected.

Description of Proposal

In general

The proposal provides a one-year refundable income tax credit for 2021, referred to as the 2021 recovery rebate. The rebate may be paid as an advance refund before the taxpayer files a 2021 income tax return.

An eligible individual is allowed a refundable income tax credit for the first taxable year beginning in 2021 equal to the sum of:

- \$1,400 (\$2,800 in the case of a joint return), and
- \$1,400 for each dependent of the individual.⁵⁹

An eligible individual is any individual other than: (1) a nonresident alien; (2) an estate or trust; or (3) a dependent.⁶⁰

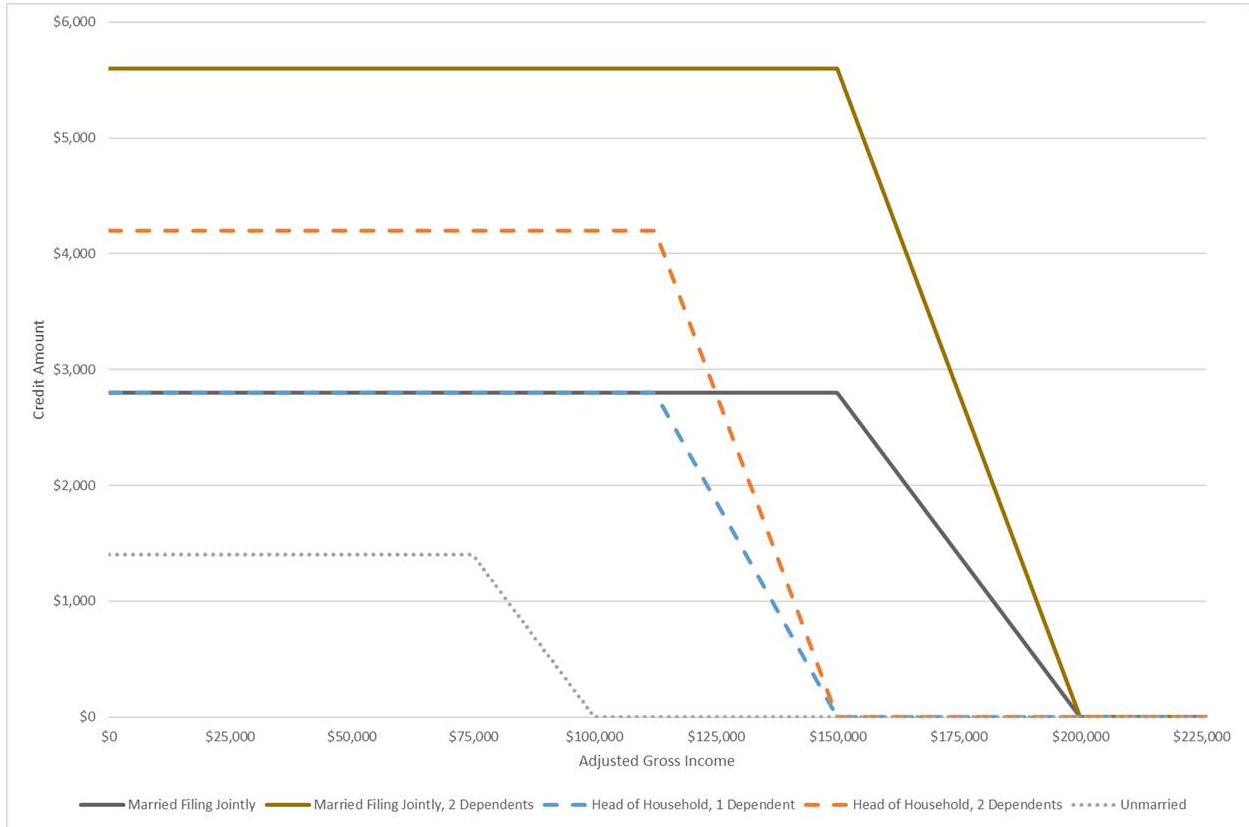
The amount of the credit is phased out above certain income levels.⁶¹ For joint filers or a surviving spouse, the credit phases out ratably over a range beginning at \$150,000 and ending at \$200,000 of AGI. For heads of household, the credit phases out between \$112,500 and \$150,000 of AGI. For all other return filers, the credit phases out between \$75,000 and \$100,000 of AGI. Figure 1 illustrates the credit amount by AGI for selected filing status and dependent combinations.

⁵⁹ Proposed sec. 6428B(b). A dependent is defined in section 152 of the Code.

⁶⁰ Proposed sec. 6428B(c).

⁶¹ Proposed sec. 6428B(d).

Figure 1.—Proposed 2021 Recovery Rebate Credit Amount by AGI for Selected Taxpayers



Identification number requirement

A credit is allowed for an individual—that is, the taxpayer, the taxpayer’s spouse, or a dependent of the taxpayer—only if the income tax return on which the credit is claimed includes that individual’s valid identification number.⁶² Thus, in the case of a joint return that includes a valid identification for both spouses, a \$2,800 credit is allowed. In the case of a joint return that includes a valid identification number for only one spouse, a \$1,400 credit is allowed. In the case of a joint return that includes a valid identification number for neither spouse, no credit is allowed for either spouse. A \$1,400 credit is allowed for each dependent for which the taxpayer provides a valid identification number even if the return does not include a valid identification number for the taxpayer or spouse. All credit amounts are subject to the income-based phaseout described above.

For purposes of this requirement, a valid identification number is an SSN issued by the SSA on or before the due date for filing the return for the taxable year (including extensions). Unlike the 2020 recovery rebate and the 2020 additional recovery rebate, the 2021 recovery rebate credit does not require the SSN to be issued to a citizen or in relation to lawful admission

⁶² Proposed sec. 6428B(e)(3).

for employment in the United States.⁶³ As with the 2020 recovery rebate and the 2020 additional recovery rebate, two exceptions to the identification number requirement are provided. First, an adoption identification number is considered a valid identification number in the case of a qualifying child who is adopted or placed for adoption. Second, when a married couple files a joint return and at least one spouse is a member of the Armed Forces of the United States during the taxable year for which the return is filed, a full \$2,800 credit (subject to the income-based phaseout) is allowed even if the return includes a valid identification number for only one spouse.

The failure to provide a correct valid identification number is treated as a mathematical or clerical error.

Advance payments of the 2021 recovery rebate

The proposal provides that the 2021 recovery rebate may be paid as an advance refund in the form of a direct deposit to a taxpayer's bank account or as a check or prepaid debit card issued by the Secretary.⁶⁴ The amount of the advance refund is computed in the same manner as the 2021 recovery rebate, except that the calculation is made on the basis of the income tax return filed for 2019 or 2020 (instead of 2021), if available.⁶⁵ Accordingly, the amount of the advance refund generally is based on a taxpayer's filing status, number of dependents, and AGI as reported for 2019 or 2020. The Secretary is directed to issue advance refunds as rapidly as possible, consistent with efforts to make payments electronically where appropriate. No advance refund is to be made or allowed after December 31, 2021.

If a taxpayer files a 2020 income tax return and the return is processed before the additional payment determination date, the Secretary may make an additional payment to the taxpayer of any excess advance refund. The excess advance refund is the advance refund based on 2020 return information less any advance refund that was paid on based on 2019 return

⁶³ SSNs that are not issued to a citizen or in relation to lawful admission for employment in the United States include (i) SSNs for claiming a benefit financed in whole or in part from Federal funds or (ii) SSNs to individuals that could have been but were not assigned SSNs for work or benefit purposes, if certain other conditions were met. See section 205(c)(2)(B)(i) of the Social Security Act, codified as 42 U.S.C. sec. 405(c)(2)(B)(i). Prior to 2003, the SSA issued SSNs to noncitizens for valid nonwork and non-benefit reasons such as to obtain drivers' licenses or to open bank accounts; these SSNs are no longer issued, but previously-issued SSNs for these purposes have not been rescinded. See 20 C.F.R. sec. 422.104(a)(3) (2002).

⁶⁴ With respect to any payment made by the Secretary as a prepaid debit card, (1) the Secretary may not make the payment by increasing the balance of an existing prepaid debit card issued solely with respect to the 2020 recovery rebate or additional 2020 recovery rebate, but (2) may increase the balance of an existing prepaid debit card issued for other purposes (such as, for example, a Direct Express card used to pay Federal benefits). Proposed sec. 6428B(g)(9).

⁶⁵ Proposed sec. 6428B(g).

information. The additional payment determination date is the earlier of (i) 90 days after the 2020 filing deadline,⁶⁶ or (ii) September 1, 2021.

If a taxpayer did not file an income tax return for 2019 or 2020 (or if the return has been filed but is not yet processed by the IRS) at the time the Secretary makes a determination regarding payments of advance refunds, the Secretary may determine the eligibility of individuals and the advance refund amount that they may be paid on the basis of information available to the Secretary. Payments for such individuals may be provided to the individual's representative payee or fiduciary for a Federal benefit program, on the condition that the entire payment is used for the benefit of the individual.

An individual who died before January 1, 2021, is not eligible to receive the advance refund. If a married couple files a joint return and one spouse died before January 1, 2021, the surviving spouse is allowed (subject to other requirements) a \$1,400 payment (subject to the income-based phaseout). No additional payment is issued with respect to dependents of a taxpayer who died before January 1, 2021 (or, in the case of joint return, if both taxpayers died before January 1, 2021). When a married couple has filed a joint return and one spouse died before January 1, 2021 who was a member of the Armed Forces of the United States during the taxable year for which the return is filed, a \$1,400 payment (subject to the income-based phaseout) is allowed if the return includes a valid identification number for the deceased spouse but no valid identification number for the other spouse.

The amount of the recovery rebate credit allowed on a taxpayer's 2021 income tax return (based on 2021 information) must be reduced by any advance refund received during 2021 (based on 2019 or 2020 information).⁶⁷ If the 2021 recovery rebate less the advance refund is a positive number (because, for example, a qualifying child was born to the taxpayer during 2021), the taxpayer is allowed that difference as a refundable credit against 2021 income tax liability. If, however, the result is negative (because, for example, the taxpayer's AGI was higher in 2021 and was in the phaseout range), the taxpayer's 2021 tax liability is not increased by that negative amount. In addition, a taxpayer that does not receive an advance refund may claim the 2021 recovery rebate on his or her 2021 income tax return. Failure to reduce the 2021 recovery rebate by the advance refund is treated as a mathematical or clerical error.

The advance refund is not includible in gross income.⁶⁸

⁶⁶ The 2020 filing deadline is specified in section 6072(a) and is April 15, 2021. However, the 2020 filing deadline must be determined after taking into account any period disregarded under section 7508A if such disregard applies to substantially all 2020 income tax returns.

⁶⁷ Proposed sec. 6428B(f).

⁶⁸ Under section 6409, the 2021 recovery rebate is disregarded in the administration of Federal programs and Federally assisted programs. Any refund due to the credit, including any advance payment of the credit, is not taken into account as income and is not taken into account as resources for a period of 12 months from receipt for purposes of determining eligibility for benefits or assistance under any Federal program or under any State or local program financed with Federal funds.

As soon as practicable after the distribution of the advance refund, the Secretary is required to send a notice by mail to the taxpayer's last known address that indicates the method by which the payment was made, the amount of such payment, a phone number at the IRS to report any error with respect to such payment, and such other information as the Secretary determines appropriate. The Secretary also is required to carry out a robust and comprehensive outreach program to ensure that taxpayers for whom the Secretary might not otherwise have the necessary information to make an advance payment, such as non-filers, are aware of their eligibility for advance refunds and the 2021 recovery rebates and are provided assistance in applying for such refunds and credits.

The Secretary is provided regulatory authority as may be necessary or appropriate to carry out the purposes of the 2021 recovery rebate credit, including authority to allow taxpayers to provide the Secretary with information sufficient to make an advance refund to the taxpayer if such information is not otherwise available.⁶⁹ The Secretary also is provided specific regulatory authority to ensure that in determining the amount of the 2021 recovery rebate, an individual is not taken into account more than once, including by being claimed by different taxpayers or by reason of a change in filing status or dependent status between the tax year used to make the advance refund (2019 or 2020) and the tax year of eligibility for the 2021 recovery rebate (2021).

Treatment of the U.S. territories

Under the proposal, the Secretary is directed to make payments to each mirror Code territory (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) that relate to the cost (if any) of each territory's 2021 recovery rebate. The Secretary is further directed to make similar payments to each non-mirror Code territory (American Samoa and Puerto Rico).

The Secretary is directed to pay to each mirror Code territory amounts equal to the aggregate amount of the credits allowable by reason of the proposal to that territory's residents against its income tax. These amounts are determined by the Secretary based on information provided by the government of the respective territory.

To each non-mirror Code territory, the Secretary is required to pay amounts estimated by the Secretary as being equal to the aggregate credits that would have been allowed to residents of that territory if a mirror Code tax system had been in effect in that territory. Accordingly, the total amount of payments to a non-mirror Code territory is an estimate of the aggregate amount of the credits that would be allowed to the territory's residents if the credit provided by the proposal to U.S. residents were provided by the territory to its residents. These payments will not be made to any U.S. territory unless it has a plan that has been approved by the Secretary under which the territory will promptly distribute the payment to its residents.

No credit against U.S. income taxes is permitted under the proposal for any person to whom a credit is allowed against territory income taxes as a result of the proposal (*i.e.*, under that

⁶⁹ Proposed sec. 6428B(h). In 2020, the Secretary established a non-filer portal and provided a method to file a simplified Federal income tax return so that non-filers could provide information to the Secretary to receive the advance refund with respect to the 2020 recovery rebate.

territory's mirror income tax). Similarly, no credit against U.S. income taxes is permitted for any person who is eligible for a payment under a non-mirror Code territory's plan for distributing to its residents the payments described above from the U.S. Treasury.

The Secretary is directed to pay to each territory, in addition to the amounts described above, an amount equal to the territory's administrative expenses relating to the 2021 recovery rebate up to \$10 million for Puerto Rico and \$500,000 for each of the other territories. Such amounts are determined by the Secretary based on information provided by the government of the respective territory.

Exception from reduction or offset

Any refund payable as an advance refund or as a similar payment to a resident of the U.S. territories is not subject to reduction or offset by other assessed Federal taxes that would otherwise be subject to levy or collection. In addition, these refunds or payments are not subject to offset for other taxes or non-tax debts owed to the Federal government or State governments.

Effective Date

The proposal is effective on the date of enactment.

PART II—CHILD TAX CREDIT

A. Child Tax Credit Improvements

Present Law

In general

Taxpayers are allowed a child tax credit of \$2,000 for each qualifying child.⁷⁰ The aggregate amount of otherwise allowable child tax credit is phased out for taxpayers with income over a threshold amount of \$400,000 for taxpayers filing jointly and \$200,000 for all other taxpayers.⁷¹ The otherwise allowable child tax credit amount is reduced by \$50 for each \$1,000 (or fraction thereof) of modified AGI over the applicable threshold amount. For purposes of this limitation, modified AGI means AGI increased by any amount excluded from gross income under section 911 (foreign earned income exclusion), 931 (exclusion of income for a bona fide resident of American Samoa), or 933 (exclusion of income for a bona fide resident of Puerto Rico).⁷²

The name and SSN of the qualifying child must appear on the return, and the SSN must be issued before the due date for filing the return.⁷³ The SSN also must be issued to a citizen or national of the United States or pursuant to a provision of the Social Security Act relating to the lawful admission for employment in the United States.⁷⁴ The TIN of the taxpayer must be issued on or before the due date for filing the return.⁷⁵

Partial refundability and calculation of additional child tax credit

The child tax credit is generally a nonrefundable tax credit taken against income tax liability. The credit is allowable against both the regular tax and the alternative minimum tax.⁷⁶

⁷⁰ Sec. 24(a), (h)(2). For taxable years beginning after December 31, 2025, the amount of the credit is \$1,000 for each qualifying child.

⁷¹ Sec. 24(b), (h)(3). For taxable years beginning after December 31, 2025, the modified AGI threshold amounts at which the credit begins to phase out are \$75,000 for individuals who are not married, \$110,000 for married individuals filing joint returns, and \$55,000 for married individuals filing separate returns.

⁷² Sec. 24(b)(1).

⁷³ Sec. 24(h)(7). For taxable years beginning after December 31, 2025, the child tax credit may be claimed if the TIN of the qualifying child, rather than the SSN of the child, appears on the return. Sec. 24(e)(1).

⁷⁴ See sec. 205(c)(2)(B)(i)(I) (or that portion of subclause (III) that relates to subclause (I)) of the Social Security Act.

⁷⁵ Sec. 24(e)(2).

⁷⁶ Sec. 26(a).

In some circumstances, all or a portion of the otherwise allowable credit is treated as a refundable credit (the “additional child tax credit”).⁷⁷ The credit is treated as refundable in an amount equal to 15 percent of earned income in excess of \$2,500 (the “earned income formula”).⁷⁸ Earned income generally has the same definition as for purposes of the EITC and is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings.⁷⁹ For purposes of the additional child tax credit, only items taken into account in computing taxable income are treated as earned income.⁸⁰ However, combat pay that is excluded from gross income under section 112 is also taken into account.

A taxpayer with three or more qualifying children may determine the additional child tax credit using the “alternative formula,” if this results in a larger additional child tax credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer’s Social Security taxes exceed the taxpayer’s EITC.⁸¹

The maximum amount of the additional child tax credit is \$1,400 per qualifying child.⁸² This amount is indexed for inflation, although the amount may not exceed the \$2,000 amount of the nonrefundable child tax credit.⁸³

Withholding

Chapter 24 of the Code provides rules for employers to deduct and withhold amounts from employee wages for the payment of income tax. Under rules determined by the Secretary, an employee may be entitled to a withholding allowance that reduces the amount of income tax withholding. A taxpayer’s withholding allowances, pursuant to Section 3402(f)(1)(C), take into

⁷⁷ Sec. 24(d).

⁷⁸ Sec. 24(d)(1)(B)(i), (h)(6). For taxable years beginning after December 31, 2025, the earned income threshold for the refundable child tax credit is \$3,000.

⁷⁹ Sec. 32(c)(2).

⁸⁰ Sec. 24(d)(1)(B)(i). For example, some ministers’ parsonage allowances are considered self-employment income, see section 1402(a)(8), and thus are considered earned income for purposes of computing the EITC, but they are excluded from gross income for income tax purposes and thus are not considered earned income for purposes of the additional child tax credit.

⁸¹ Sec. 24(d)(1)(B)(ii).

⁸² Sec. 24(h)(5). For taxable years beginning after December 31, 2025, there is no separately stated maximum amount of the additional child tax credit; however, the refundable credit may not exceed the total amount of the credit of \$1,000 for taxable years beginning after December 31, 2025.

⁸³ The maximum amount remains \$1,400 for taxable years beginning in 2021. Rev. Proc. 2020-45, 2020-46 I.R.B. 1016.

account the number of children for whom it is reasonably expected that the taxpayer is entitled to a child tax credit.⁸⁴

Credit for other dependents

An individual is allowed a \$500 nonrefundable credit for each dependent of the taxpayer as defined in section 152, other than a qualifying child as defined for purposes of the child tax credit.⁸⁵

Application of the child tax credit in the territories of the United States

The three mirror Code territories (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) have, under their mirror Codes, a child tax credit identical to that in the U.S. Code. A resident of one of these territories claims the child tax credit on the income tax return filed with the territory's revenue authority. The non-mirror Code territories (Puerto Rico and American Samoa) do not have child tax credits under their internal revenue laws.

Residents of the territories with three or more qualifying children, under the alternative formula, receive the additional child tax credit under the U.S. Code. The U.S. Treasury makes payments to each territory other than Puerto Rico to cover the cost of this credit. Residents of Puerto Rico claim the additional child tax credit under the alternative formula by filing a Form 1040-SS or Form 1040-PR with the IRS.

Description of Proposal

Temporary increase in credit amount and qualifying child age limit

Under the proposal, the child tax credit is increased from \$2,000 to \$3,000 for 2021.⁸⁶ In the case of a qualifying child who has not attained the age of 6 as of the close of the calendar year, the credit is increased to \$3,600.⁸⁷ In addition, the term "qualifying child" is broadened to include a qualifying child who has not attained the age of 18 (instead of 17).⁸⁸

⁸⁴ Sec. 3402(f)(1)(C).

⁸⁵ An individual who is a qualifying child for purposes of the dependent rules under section 152, but not a qualifying child for purposes of the child tax credit (*e.g.*, a child who is age 17 or 18, or a full-time student under age 24) is eligible to be a qualifying dependent for purposes of the \$500 nonrefundable credit for other dependents. For taxable years beginning after December 31, 2025, there is no tax credit for other dependents.

⁸⁶ Proposed sec. 24(i)(3). The proposal applies for taxable years beginning in 2021.

⁸⁷ *Ibid.*

⁸⁸ Proposed sec. 24(i)(2). Thus, for 2021, taxpayers may not claim a \$500 credit for other dependents with respect to these taxpayers. Sec. 24(h); Prop. Sec. 24(i)(2)(B).

Finally, the child tax credit amount is subject to a second phaseout, which applies in addition to the phaseout under present law.⁸⁹ The second phaseout applies to taxpayers with income above an applicable threshold amount. The applicable threshold amounts are lower than those under the present-law child tax credit phaseout: \$150,000 for taxpayers filing jointly (as compared to \$400,000 for the present-law phaseout), \$150,000 for surviving spouses (as compared to \$200,000), \$112,500 for head of household taxpayers (as compared to \$200,000), and \$75,000 for all other taxpayers (as compared to \$200,000). The amount of child tax credit is reduced by \$50 for each \$1,000 (or fraction thereof) of modified AGI over the applicable threshold amount. However, the additional phaseout is limited so that it only applies to the temporary increased child tax credit for 2021 (\$1,600 per child under age 6 and \$1,000 per child age 6 and older); it does not reduce the child tax credit amount provided to a taxpayer under present law.⁹⁰

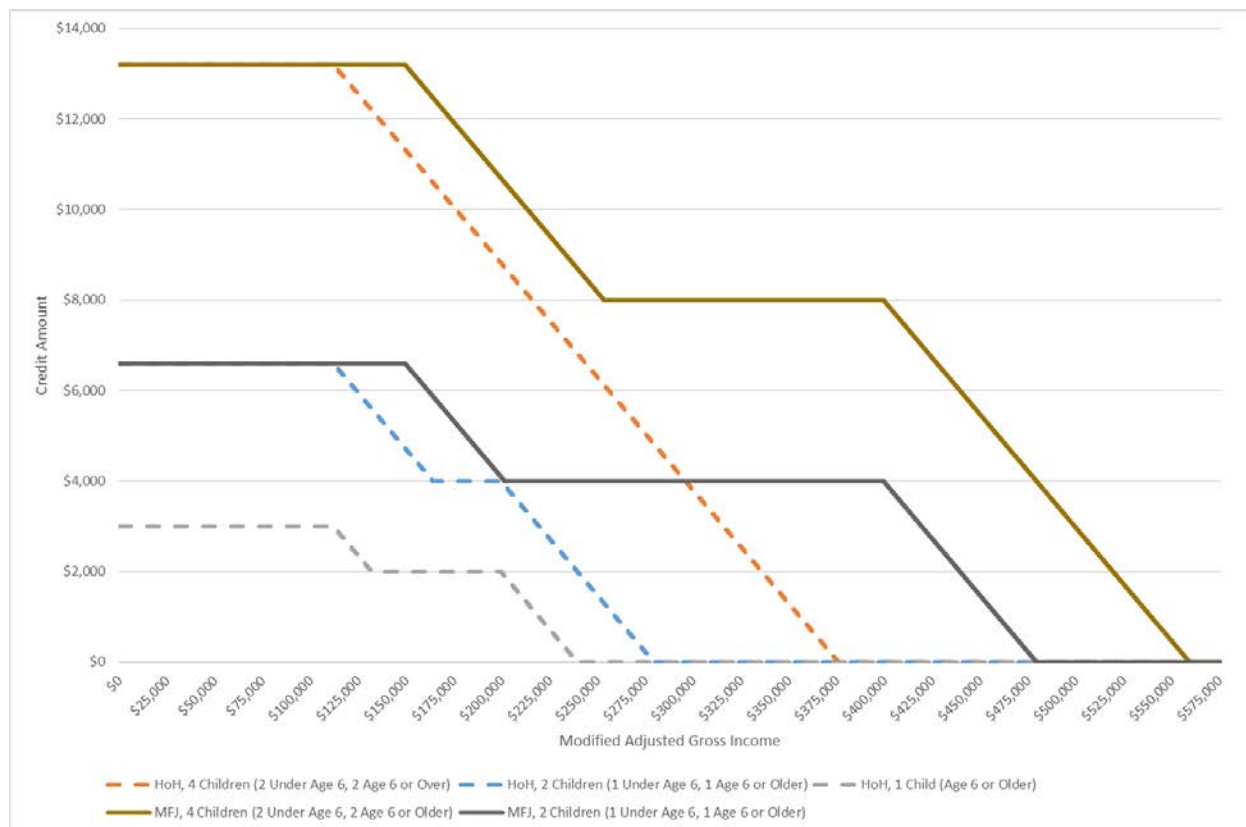
Figure 2 illustrates the proposed child tax credit by modified AGI for selected combinations of filing status and number of qualifying children.

⁸⁹ Proposed sec. 24(i)(4).

⁹⁰ Under the proposal, the reduction in credit due to the additional phaseout is limited to the lesser of (1) the applicable credit increase amount or (2) five percent of the applicable phaseout threshold range. Proposed sec. 24(i)(4)(C). The applicable credit increase amount is the difference between (1) the aggregate child tax credit allowable under the proposal and (2) the aggregate child tax credit allowable under the proposal if the credit amount was not increased to \$3,000 or \$3,600 (from \$2,000), both determined without application of any phaseout. The applicable phaseout threshold range is the difference between (1) the threshold amount for the taxpayer under present law and the (2) applicable threshold amount for the taxpayer under the proposal, or \$250,000 for taxpayers filing jointly, \$87,500 for heads of households, \$50,000 for surviving spouses, and \$125,000 for all other taxpayers.

For example, a head of household with one child age 7 and modified AGI of \$140,000 would qualify for a \$2,000 child tax credit in 2021 under present law. Under the proposal, the base child tax credit amount for such child would increase to \$3,000, but this amount would be reduced by the new phaseout. The reduction in credit would be \$50 for each \$1,000 (or fraction thereof) that modified AGI exceeds \$112,500 or \$1,400 ($\$50 * 28$). However, the reduction is limited by the lesser of (1) the applicable credit increase amount of \$1,000 ($\$3,000 - \$2,000$) or (2) five percent of the applicable phaseout threshold range or \$4,375 ($.05 * \$87,500$). Thus, under the proposal, the reduction is limited to \$1,000 (not \$1,400), and the child tax credit for this taxpayer is \$2,000. How the credit amount varies across a range of modified AGI for a such a head of household (with a child age 6 or older) is also illustrated in Figure 2.

**Figure 2.—Proposed Child Tax Credit for 2021
by Modified AGI for Selected Taxpayers**



Temporary full refundability

For 2021, the child tax credit is made fully refundable for taxpayers with a principal place of abode in the United States for more than one half of the taxable year.⁹¹ Thus, the child tax credit is generally refundable up to \$3,000 (or \$3,600) per qualifying child, without regard to the earned income formula or the alternative formula. In the case of a joint return, at least one spouse must satisfy the principal place of abode requirement. Principal place of abode is determined as provided in section 32.⁹²

The AGI limitation on the credit still applies (regardless of refundability), and the \$500 credit for dependents other than qualified children remains nonrefundable.

⁹¹ Proposed sec. 24(i)(1). For purposes of the principal place of abode rule, the United States includes the States and the District of Columbia. Sec. 7701(a)(9).

⁹² Thus, a member of the Armed Forces of the United States stationed outside the United States while serving on extended active duty is treated as having a principal place of abode in the United States.

Temporary advance payments of the child tax credit

In general

The proposal creates a new section 7527A, under which the Secretary is directed to establish a program to make monthly advance payments of the child tax credit to eligible taxpayers.⁹³ Each advance payment is 1/12 of an advance annual amount for the calendar year. However, if the Secretary determines that it is not administratively feasible to make monthly advance payments, the Secretary may make advance payments on the basis of a longer interval and adjust the amount of advance payments to take into account the changed interval.⁹⁴

A taxpayer may receive an advance payment in the form of a direct deposit to his or her bank account or a debit card issued by the Secretary.⁹⁵

Monthly advance payments are only to be made for months between July 1, 2021 and December 31, 2021.⁹⁶

Annual advance amount

A taxpayer's annual advance amount for a calendar year is the taxpayer's child tax credit for the taxable year beginning in such calendar year, but calculated based on a reference taxable year ("reference year").⁹⁷ For purposes of this calculation, (1) the taxpayer's principal place of abode is determined based on the reference year;⁹⁸ (2) the taxpayer's modified AGI for the reference year is used to determine any phaseout of credit; and (3) the taxpayer is treated as having only the number of qualifying children the taxpayer had in the reference year.⁹⁹ For purposes of this calculation, the age of any qualifying children and their status as qualifying children is determined by taking into account the passage of time. Thus, for example, a qualifying child who was 17 in the reference year would not be a qualifying child for purposes of the calculation. In addition, a qualifying child is not taken into account for the annual advance amount if the child is deceased as of the beginning of the calendar year for which the credit is

⁹³ Proposed sec. 7527A(a).

⁹⁴ Proposed. sec. 7527A(e). For example, if the Secretary determines that it is administratively feasible to only make payments every two months, each payment would equal 1/6 of the advance annual amount.

⁹⁵ Proposed. sec. 7527A(f). The advance payments generally must comply with the electronic payment requirements of 31 U.S.C. sec. 3332.

⁹⁶ Proposed. sec. 7527A(g).

⁹⁷ Proposed sec. 7527A(b).

⁹⁸ If the information on the taxpayer's tax return for the reference year is insufficient to determine the taxpayer's principal place of abode, the Secretary may make that determination based on other sources. Proposed. sec. 7527A(b)(4).

⁹⁹ Proposed sec. 7527A(b)(1).

determined.¹⁰⁰ Thus, for 2021, a child that is known to the Secretary as being deceased as of January 1, 2021 is not taken into account for the advance amount for taxable year 2021.

The reference year is the taxpayer's taxable year beginning in the previous calendar year or, if the taxpayer did not file a tax return for that year, the taxpayer's taxable year beginning in the second previous calendar year.¹⁰¹ The Secretary may modify the advance annual amount for a calendar year to take into account a tax return filed by the taxpayer, including by treating the taxable year of the return as the new reference year.¹⁰² The Secretary may also modify the advance annual amount to take into account any other information provided to the Secretary by the taxpayer that allows the Secretary to more closely determine the taxpayer's child tax credit for the taxable year.¹⁰³ Finally, if the Secretary does modify the advance annual amount, the Secretary may increase or decrease subsequent advance payments in the calendar year in order to account for excessive or deficient prior advance payments based on the pre-modified advance annual amount.¹⁰⁴

The Secretary is directed to create an online portal to allow taxpayers to provide information regarding (1) a change in the number of the taxpayer's qualifying children, including by reason of the birth of a qualifying child; (2) a change in the taxpayer's marital status; (3) a significant change in the taxpayer's income; and (4) any other factors that the Secretary may provide.¹⁰⁵ A taxpayer may also use the online portal to elect out of advance payments.¹⁰⁶

Withholding and administrative provisions

The Secretary must take the receipt of advance payments of the child tax credit into account in determining the rules regarding withholding allowances.

The Secretary must provide notice to the taxpayer of the aggregate amount of advance payments made to the taxpayer during the calendar year and other information as the Secretary determines appropriate by no later than January 31 of the calendar year following the year in which any such payments were made.¹⁰⁷

¹⁰⁰ Proposed sec. 7527A(b)(5).

¹⁰¹ Proposed sec. 7527A(b)(2).

¹⁰² Proposed sec. 7527A(b)(3)(A).

¹⁰³ *Ibid.*

¹⁰⁴ Proposed sec. 7527A(b)(3)(B).

¹⁰⁵ Proposed sec. 7527A(c)(2).

¹⁰⁶ Proposed sec. 7527A(c)(1).

¹⁰⁷ Proposed sec. 7527A(d).

Any advance payment is not subject to reduction or offset by other assessed Federal taxes that would otherwise be subject to levy or collection, by other taxes, or by non-tax debts owed to the Federal government or State governments.¹⁰⁸

Reconciliation

The amount of the child tax credit allowed for any taxable year is reduced by the aggregate advance payments made during the taxable year.¹⁰⁹ A failure to reduce the credit is treated as a mathematical or clerical error.

If the taxpayer receives advance payments in excess of the taxpayer's allowable child tax credit during a taxable year, the taxpayer's tax liability for the taxable year is increased by the excess amount.¹¹⁰ This increase in tax liability is not considered to be part of a taxpayer's regular tax liability.¹¹¹ However, for taxpayers that have modified AGI below certain thresholds, the excess amount may be reduced by a safe harbor amount, limiting the increase in tax liability and allowing the taxpayer to retain a portion of the excess amount. The safe harbor amount is \$2,000 for each child incorrectly taken into account in determining the advance payment amount, subject to a phaseout based on taxpayer modified AGI.¹¹²

Regulatory authority

The Secretary is directed to issue regulations or other guidance the Secretary determines is necessary or appropriate to carry out the advance payment program, the temporary changes to the child tax credit, and the reconciliation of the child tax credit and advance payments.¹¹³ This includes regulations or other guidance that provide for the application of these rules in cases where the filing status of the taxpayer changes between taxable years.

¹⁰⁸ Proposed sec. 7527A(f)(4).

¹⁰⁹ Proposed sec. 24(j)(1).

¹¹⁰ Proposed sec. 24(j)(2).

¹¹¹ See sec. 26(b). Because of this, the taxpayer may not use nonrefundable tax credits to offset the increase. Sec. 26(a).

¹¹² The safe harbor amount is \$2,000 multiplied by the difference in number of qualifying children used to determine the advance amount and number of qualifying children used to determine the credit for the taxable year. The full safe harbor amount is allowed to taxpayers with modified AGI of up to \$60,000 for married taxpayers filing jointly and surviving spouses, \$50,000 for heads of households, and \$40,000 for all other taxpayers. The safe harbor amount is reduced ratably over these same sized intervals for each filing status, respectively. Thus, the safe harbor is \$0 as modified AGI equals or exceeds \$120,000 for married taxpayers filing jointly and surviving spouses, \$100,000 for heads of households, and \$80,000 for all other taxpayers.

¹¹³ Proposed sec. 7527A(h).

Application of the child tax credit in the territories of the United States

For 2021, the child tax credit is made fully refundable for taxpayers who are bona fide residents of Puerto Rico for the taxable year, claimed by filing a tax return with the IRS.¹¹⁴ Thus, for bona fide residents of Puerto Rico, the child tax credit is generally refundable up to \$3,000 (or \$3,600) per qualifying child, without regard to the earned income formula or alternative formula, but subject to the modified AGI phaseouts.

The child tax credit advance payment program does not apply to the territories.¹¹⁵

Additional rules for taxpayers in Puerto Rico, American Samoa, and the mirror Code territories are provided by section 9612 of the bill (described in the following section).

Effective Date

The proposal applies to taxable years beginning after December 31, 2020.

¹¹⁴ Proposed sec. 24(i)(2).

¹¹⁵ *Ibid.*

B. Application of Child Tax Credit in Possessions

Present Law

The present law rules for the child tax credit in the territories of the United States are described in the previous section.

Description of Proposal

Under the proposal, the Secretary must make payments to each territory that relate to the cost or approximate cost of that territory's child tax credit, or make payments of the credit directly to territory residents.

Mirror Code territories

The proposal directs the Secretary to make payments to each of Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands in an amount equal to the loss in revenue by reason of the application of the child tax credit to the territory's mirror Code for the taxable year.¹¹⁶ This amount is determined by the Secretary based on information provided by the government of the territory. Because of their mirror Codes, the changes to the child tax credit made by section 9611 of the bill (described in the preceding section) apply to these territories for 2021.

No child tax credit under the Internal Revenue Code is permitted for any resident of a mirror Code territory with respect to whom a child tax credit is allowed against income taxes of the territory.

Puerto Rico

For 2021, bona fide residents of Puerto Rico may claim a fully refundable child tax credit by filing a tax return with the IRS.¹¹⁷

For taxable years beginning after 2021, bona fide residents of Puerto Rico may claim an additional child tax credit up to the maximum amount¹¹⁸ from the U.S. Treasury under the alternative formula, but determined without regard to the three-child limitation, by filing a return with the IRS.¹¹⁹

¹¹⁶ Proposed sec. 24(k)(1).

¹¹⁷ Sec. 9611 of the bill (described in the preceding section).

¹¹⁸ This amount is currently \$1,400 for taxable years beginning in 2021.

¹¹⁹ Proposed sec. 24(k)(2).

American Samoa

The proposal directs the Secretary to make payments to American Samoa in an amount estimated by the Secretary as being equal to the aggregate benefits that would have been allowed to residents of American Samoa under the child tax credit if a mirror Code tax system had been in effect in American Samoa in that taxable year.¹²⁰ These amounts include, for 2021, amounts resulting from changes made by section 9611 of the bill (described in the preceding section).

The proposal prohibits the Secretary from making these payments unless American Samoa has a plan approved by the Secretary to promptly distribute the payments to its residents. For years with respect to which American Samoa has an approved plan, no child tax credit under the Internal Revenue Code is permitted for any person who is eligible for a payment under the plan. If American Samoa does not have a plan in place for a taxable year, a bona fide resident of American Samoa may claim a child tax credit by filing a return with the IRS under rules similar to those for Puerto Rico, described above.

Effective Date

The proposal applies to taxable years beginning after December 31, 2020.

¹²⁰ Proposed sec. 24(k)(3).

PART III—EARNED INCOME TAX CREDIT

A. Strengthening the Earned Income Tax Credit for Individuals with No Qualifying Children

Present law

In general

Low- and moderate-income workers may be eligible for the refundable earned income tax credit (“EITC”). The amount of the EITC is based on the presence and number of qualifying children in the worker’s family, filing status, AGI, and earned income.¹²¹

The EITC generally equals a specified percentage of earned income.¹²² Earned income for this purpose cannot exceed a maximum dollar amount, known as the earned income amount. The maximum EITC amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For a taxpayer with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum EITC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For a taxpayer with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed. The specified percentage, maximum dollar amount, and phaseout rate and range vary with filing status and number of children. Four separate credit percentage schedules apply: one for taxpayers with no qualifying children, one for taxpayers with one qualifying child, one for taxpayers with two qualifying children, and one for taxpayers with three or more qualifying children.¹²³

For an individual to be a qualifying child for purposes of the parent’s (or parents’) EITC, generally that individual must meet the relationship, age, and residency tests under section 152 (described above in the General Background section).¹²⁴

The EITC may be claimed by a taxpayer if the taxpayer is a U.S. citizen or a resident alien.¹²⁵ An individual who is a nonresident alien for any portion of the taxable year is not eligible to claim the EITC unless an election is in effect for the year under section 6013(g) or (h) (relating to an individual who is married to a citizen or resident of the United States at the end of the year). In addition, individuals who claim the benefits of section 911 (relating to the income

¹²¹ Sec. 32.

¹²² Sec. 32(a), (b).

¹²³ Sec. 32(b). All income thresholds are indexed for inflation annually.

¹²⁴ Sec. 32(c)(3)(A). See section 152(c)(1) for the definition of qualifying child. For purposes of the EITC the support test in section 152(c)(1)(D) is disregarded. The residency test in section 152(c)(1)(B) is only satisfied if the principal place of abode is in the United States.

¹²⁵ Sec. 32(c)(1)(D).

exclusion election available to U.S. citizens or resident aliens living abroad) are not eligible to claim the EITC.¹²⁶

To claim the EITC, the taxpayer must include the taxpayer's valid SSN and valid SSN for the qualifying child (and, if married, the spouse's SSN) on his or her tax return.¹²⁷ For these purposes, a valid SSN is an SSN issued to an individual, other than an SSN issued to an individual solely for the purpose of applying for or receiving Federally funded benefits, on or before the due date for filing the return for the year.¹²⁸

EITC for taxpayers with no qualifying children

A taxpayer with no qualifying children may claim a credit if the taxpayer is age 25 or older and below age 65, has a principal place of abode in the United States for more than half of the taxable year, and cannot be claimed as a dependent on anyone else's return.¹²⁹ For purposes of the principal place of abode requirement, a member of the Armed Forces of the United States stationed outside the United States while serving on extended active duty is treated as having a principal place of abode in the United States.¹³⁰

For 2021, the credit is 7.65 percent of earned income up to an earned income amount \$7,100, resulting in a maximum credit of \$543.¹³¹ The maximum credit is available for a taxpayer with earned income between \$7,100 and \$8,880 (\$14,820 if married filing jointly). The credit begins to phase out at a rate of 7.65 percent of earned income above \$8,880 (\$14,820 if married filing jointly) resulting in a \$0 credit at \$15,980 of earned income (\$21,920 if married filing jointly). Table 1 shows these parameters for the childless EITC in comparison to the EITC for taxpayers with different numbers of qualifying children.

¹²⁶ Sec. 32(c)(1)(C).

¹²⁷ Sec. 32(c)(1)(E), (c)(3)(D), (m).

¹²⁸ Sec. 205(c)(2)(B)(i)(II) (and that portion of sec. 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act.

¹²⁹ Sec. 32(c)(1)(A)(ii).

¹³⁰ Sec. 32(c)(4).

¹³¹ The inflation adjusted amounts are provided in Revenue Procedure 2020-45, 2020-46 I.R.B. 1016.

Table 1.—2021 EITC Schedule¹³²

	Credit percentage	Earned income amount	Maximum credit	Phaseout range (single, head of household)	Phaseout range (joint filers)	Phaseout percentage
Childless	7.65%	\$7,100	\$543	\$8,880 - \$15,980	\$14,820 - \$21,920	7.65%
1 qualifying child	34%	\$10,640	\$3,618	\$19,520 - \$42,158	\$25,470 - \$48,108	15.98%
2 qualifying children	40%	\$14,950	\$5,980	\$19,520 - \$47,915	\$25,470 - \$53,865	21.06%
3 or more qualifying children	45%	\$14,950	\$6,728	\$19,520 - \$51,464	\$25,470 - \$57,414	21.06%

Description of Proposal

For 2021, the proposal expands EITC eligibility and increases the amount of the credit for taxpayers with no qualifying children.¹³³

Temporary changes to minimum and maximum age

For 2021, in the case of the credit for a taxpayer with no qualifying children, the minimum age is reduced from 25 to 19.¹³⁴ However, if the individual is a specified student (or, in the case of a married individual, if both the individual and the individual's spouse are specified students), the minimum age is reduced from 25 to 24.¹³⁵ A specified student means, with respect to a taxable year, an individual who is an eligible student during at least five calendar months during the year. An eligible student is defined in section 25A(b)(3) (relating to the American opportunity tax credit) as a student who, with respect to any academic period,

¹³² *Ibid.*

¹³³ Proposed sec. 32(n). The proposal applies for taxable years beginning in 2021.

¹³⁴ Proposed sec. 32(n)(1)(A), (B)(i).

¹³⁵ Proposed sec. 32(n)(1)(A), (B)(ii). The proposal requires the Secretary to develop and implement procedures for confirming a taxpayer's status as a specified student using information returns made with respect to such taxpayer under section 6050S (returns relating to higher education tuition and related expenses).

meets the requirements of section 484(a)(1) of the Higher Education Act of 1965 and is carrying at least half the normal full-time work load for the course of study the student is pursuing.

The proposal further reduces the minimum age to 18 for any qualified former foster youth or qualified homeless youth.¹³⁶ A qualified former foster youth is an individual who, at the age of 14 or older, was in foster care provided under the supervision or administration of an entity administering (or eligible to administer) a plan under part B¹³⁷ or part E¹³⁸ of Title IV of the Social Security Act. A qualified former foster youth must give the applicable entity consent to disclose to the Secretary information related to the taxpayer's status as a qualified former foster youth.

A qualified homeless youth is an individual who is certified by a local educational agency or a financial aid administrator during the year as being either (1) an unaccompanied youth who is a homeless child or youth or (2) unaccompanied, at risk of homelessness, and self-supporting.¹³⁹ A qualified homeless youth must give applicable educational agency or financial aid administrator consent to disclose to the Secretary information related to the taxpayer's status as a qualified homeless youth.

The proposal also temporarily removes the upper age limit on the credit for taxpayers with no qualifying children.¹⁴⁰ Therefore, taxpayers 65 and older without qualifying children may claim the credit in 2021.

Temporary changes to the credit percentage, earned income amount, and phaseout amount

For 2021, the proposal increases the amount of the credit for taxpayers with no qualifying children.¹⁴¹ The proposal increases the credit percentage and phaseout percentage from 7.65 percent to 15.3 percent. In addition, the earned income amount is increased to \$9,820, and the beginning of the phaseout range for non-joint filers is increased to \$11,610 (\$17,550 if married filing jointly). The maximum amount of the credit is \$1,502. The proposed changes to the EITC for taxpayers with no qualifying children as compared to present law is shown in Figure 3.

¹³⁶ Proposed sec. 32(n)(1)(B)(iii), (D), (C).

¹³⁷ 42 U.S.C. sec. 621-628b.

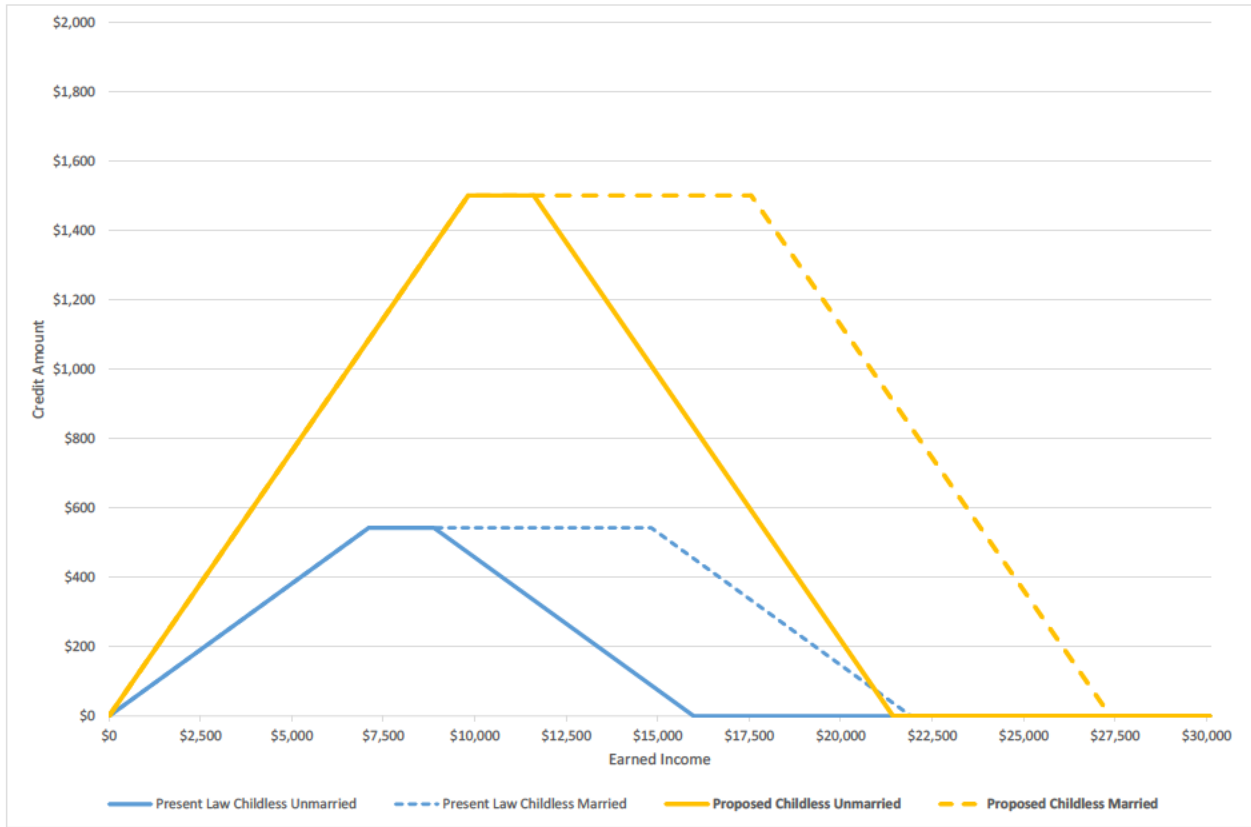
¹³⁸ 42 U.S.C. sec. 670-679c.

¹³⁹ See section 480(d)(1) of the Higher Education Act of 1965, 20 U.S. Code § 1087vv, for the meaning of terms used in this definition.

¹⁴⁰ Proposed sec. 32(n)(2).

¹⁴¹ Proposed sec. 32(n)(3), (4).

Figure 3.–Proposed EITC for 2021



Effective Date

The proposal applies to taxable years beginning after December 31, 2020.

**B. Taxpayer Eligible for Childless Earned Income Credit
in Case of Qualifying Children Who Fail to Meet
Certain Identification Requirements**

Present Law

Any eligible taxpayer with at least one qualifying child who does not claim the EITC with respect to qualifying children due to failure to meet certain identification requirements with respect to such children (*i.e.*, providing the name, age and SSN of each of such children) may not claim the EITC for taxpayers without qualifying children.¹⁴²

Description of Proposal

The proposal repeals the rule that an eligible taxpayer with at least one qualifying child who does not claim the EITC with respect to one or more qualifying children due to failure to meet the identification requirements—including the valid SSN requirement—with respect to such children may not claim the EITC for taxpayers with no qualifying children. Accordingly, such a taxpayer may claim the EITC for taxpayers with no qualifying children.

Effective Date

The proposal applies to taxable years beginning after December 31, 2020.

¹⁴² Sec. 32(c)(1)(F).

C. Credit Allowed in the Case of Certain Separated Spouses

Present Law

An unmarried individual may claim the EITC if he or she files as a single filer or as a head of household. Married individuals generally may not claim the EITC unless they file jointly.¹⁴³ An exception to the joint return filing requirement applies to certain spouses who are separated.¹⁴⁴ Under this exception, a married taxpayer who is separated from his or her spouse for the last six months of the taxable year is not considered to be married (and, accordingly, may file a return as head of household and claim the EITC), provided that the taxpayer maintains a household that constitutes the principal place of abode for a dependent child (including a son, stepson, daughter, stepdaughter, adopted child, or a foster child) for over half the taxable year, and pays over half the cost of maintaining the household in which he or she resides with the child during the year.

Description of Proposal

The proposal changes the exception under which an otherwise married individual may claim the EITC on a separate return. Under the proposal, an otherwise married individual separated from the individual's spouse is treated as not married for purposes of the EITC if a joint return is not filed. The proposal applies only if the taxpayer lives with a qualifying child of the taxpayer for more than one-half of the taxable year and either (1) does not have the same principal place of abode as the individual's spouse during the last six months of the taxable year or (2) has a decree, instrument, or agreement (other than a decree of divorce) described in section 121(d)(3)(C)¹⁴⁵ with respect to the individual's spouse and is not a member of the same household with the individual's spouse by the end of the taxable year.

Effective Date

The proposal applies with respect to taxable years beginning after December 31, 2020.

¹⁴³ Sec. 32(d).

¹⁴⁴ Sec. 7703(b).

¹⁴⁵ Instruments under this provision include (1) a decree of separate maintenance or a written instrument written to such a decree; (2) a written separation agreement; and (3) a decree not described in (1) requiring a spouse to make payments for the support or maintenance of the other spouse.

D. Modification of Disqualified Investment Income Test

Present Law

An individual is not allowed the EITC if the aggregate amount of certain items of the individual's investment income ("disqualified income") for the taxable year exceeds a maximum amount.¹⁴⁶ The maximum amount, which is indexed for inflation, is \$3,650 for taxable years beginning in 2021.¹⁴⁷ Disqualified income is the sum of: (1) interest (both taxable and tax exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gains net income; and (5) net passive income that is not self-employment income (if greater than zero).

Description of Proposal

The proposal raises the disqualified income maximum amount to \$10,000 for taxable years beginning in 2021. The maximum amount remains indexed for inflation for taxable years beginning after 2021.

Effective Date

The proposal applies to taxable years beginning after December 31, 2020.

¹⁴⁶ Sec. 32(i).

¹⁴⁷ Sec. 32(i), (j). Rev. Proc. 2020-45, 2020-46 I.R.B. 1016.

E. Application of Earned Income Tax Credit in Possessions of the United States

Present Law

The three mirror Code territories (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) have, under their respective mirror Codes, EITCs identical to that in the U.S. Code.¹⁴⁸ Puerto Rico has an EITC under its internal tax laws.¹⁴⁹ American Samoa does not have an EITC under its internal tax laws.¹⁵⁰ Each territory that has an EITC bears the cost of the credit.

Description of Proposal

Under the proposal, the Secretary makes payments to the territories that relate to the cost to each territory of its EITC.

Puerto Rico

If Puerto Rico enacts changes to its EITC which increase the percentage of earned income allowed as a credit in a manner designed to substantially increase workforce participation, the proposal requires the Secretary to pay to Puerto Rico each calendar year, starting in 2021, a specified matching amount. The specified matching amount for a calendar year is the lesser of (1) the cost to Puerto Rico of the EITC for taxable years beginning in or with such calendar year over the base amount of such calendar year or (2) three times the base amount for such calendar year. The base amount is the greater of (1) the cost to Puerto Rico of the EITC for taxable years beginning in or with calendar year 2019 (rounded to the nearest multiple of \$1 million) or (2) \$200 million. The base amount is indexed for inflation for calendar years after 2021. For example, if Puerto Rico spends \$210 million on the EITC in 2019 and projects spending \$850 million on the EITC in 2021 (through an appropriate increase in the percentage of earned income allowed as a credit), the base amount is \$210 million (the greater of \$210 million and \$200 million) and the specified matching amount is \$630 million (the lesser of (1) \$850 million – \$210 million = \$640 million and (2) 3*\$210 million = \$630 million). For each calendar year 2021 through 2025, the proposal also directs the Secretary to pay to Puerto Rico the lesser of (1) Puerto Rico's expenditures for education efforts with respect to taxpayers and tax return preparers regarding the EITC or (2) \$1 million.

Under the proposal, the Secretary determines the cost of the EITC for Puerto Rico based on the laws of Puerto Rico, but, for purposes of this determination, the cost does not include administrative costs. Puerto Rico must provide an annual report to the Secretary each year that

¹⁴⁸ But see Northern Mariana Laws, Title 4, Division 1, Chapter 7, § 1709 (imposing an additional tax in the amount of any earned income tax credit); see also *Simpao v. Guam*, No. 04-00049 (D. Guam 2005) (holding that the mirror Code jurisdiction of Guam must either pay an earned income tax credit to its residents or change its tax code to a non-Mirror code).

¹⁴⁹ Sección 1052.01 del Código de Rentas Internas de Puerto Rico de 2011.

¹⁵⁰ Am. Samoa Code Ann. sec. 11.0530.

includes an estimate of the costs of its EITC for that year and a statement of the costs in the preceding year. The Secretary must make the payment described above after it receives the annual report and within a reasonable period of time before Puerto Rico's individual income tax filing due date. The proposal requires the Secretary to make an adjustment to a payment as soon as practicable after it determines that an estimate was inaccurate.

Mirror Code territories

The proposal requires the Secretary to make payments to Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands each calendar year starting in 2021. The amount of the required annual payment to each territory is 75 percent of the cost to that territory of its EITC in that year. For each calendar year 2021 through 2025, the proposal also directs the Secretary to pay to each territory an amount equal to the lesser of (1) the territory's expenditures for education efforts with respect to taxpayers and tax return preparers regarding the EITC or (2) \$50,000. The Secretary determines the cost of the credit and provides payments with respect to each possession under rules similar to the rules described above for Puerto Rico. The territories must provide annual reports to the Secretary that include an estimate of the costs of their EITC for the current year and a statement of the costs in the preceding year.

American Samoa

The proposal requires the Secretary to make a payment to American Samoa in each calendar year during which American Samoa has a refundable EITC designed to substantially increase workforce participation. The amount of the annual payment is the lesser of (1) 75 percent of the cost to American Samoa of such credit each year or (2) \$12 million, indexed for inflation. For each calendar year 2021 through 2025, the proposal also directs the Secretary to pay the lesser of (1) American Samoa's expenditures in that year for education efforts with respect to taxpayers and tax return preparers regarding the EITC or (2) \$50,000. The Secretary must determine the cost of the credit and must provide payments to American Samoa under rules similar to the rules described above for Puerto Rico. American Samoa must provide a report to the Secretary each year that includes an estimate of the costs of its EITC for that year and a statement of the costs in the preceding year.

Effective Date

The proposal is effective on the date of enactment of the bill.

F. Temporary Special Rule for Determining Earned Income for Purposes of the Earned Income Tax Credit

Present Law

Eligible taxpayers may claim an EITC and CTC. The amount of the EITC is based on the taxpayer's earned income.¹⁵¹ The amount of the additional child tax credit, the refundable component of the CTC, is generally based on the taxpayer's earned income.¹⁵²

In the CAA, Congress enacted a provision that allows a taxpayer to elect to calculate the taxpayer's EITC and additional child tax credit for taxable years beginning in 2020¹⁵³ using 2019 rather than 2020 earned income, if the taxpayer's earned income in 2020 is less than in 2019.¹⁵⁴

Description of Proposal

The proposal permits a taxpayer to elect to calculate the taxpayer's EITC for taxable years beginning in 2021 using 2019 rather than 2020 earned income, if the taxpayer's earned income in 2021 is less than in 2019.¹⁵⁵

For purposes of the proposal, in the case of a joint return the earned income which is attributable to the taxpayer for 2019 is the sum of the earned income which is attributable to each spouse for 2019.

For administrative purposes, the incorrect use on a return of earned income pursuant to an election under this proposal is treated as a mathematical or clerical error. An election under the proposal is disregarded for purposes of calculating gross income in the election year.

The proposal directs the Secretary to pay to the mirror Code territories (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) an amount equal

¹⁵¹ Sec. 32.

¹⁵² Sec. 24(d).

¹⁵³ The provision applies for taxable years beginning in 2021.

¹⁵⁴ Pub. L. No. 116-260, sec. 211. In addition, Congress has at times, in response to natural disasters, allowed certain taxpayers whose principal place of abode was in the disaster zone or disaster area to elect to calculate their EITC and additional child tax credit for the taxable year on the basis of their earned income from the prior taxable year. See, e.g., Pub. L. No. 116-94, sec. 204(c), December 20, 2019 (certain disasters occurring in 2018 and 2019); Pub. L. No. 115-123, sec. 20104(c), February 9, 2018 (certain California wildfires); Pub. L. No. 115-64, sec. 504(c), September 29, 2017 (hurricanes Harvey, Irma, Maria), former sec. 1400S(d) (hurricanes Katrina, Rita, and Wilma), repealed by Pub. L. No. 115-141, March 23, 2018.

¹⁵⁵ The proposal does not allow taxpayers to make an election with respect to the additional child tax credit. However, section 9611 of the bill, discussed above, makes the child tax credit fully refundable for 2021, without regard to earned income.

to the loss in revenue by reason of the application of the proposal. This amount is determined by the Secretary based on information provided by the government of the territory.

The proposal directs the Secretary to pay to the non-mirror Code territories (Puerto Rico and American Samoa) an amount estimated by the Secretary as being equal to the aggregate benefits that would have been provided to the residents of the territory from the proposal if a mirror Code tax system had been in effect in the territory. The proposal prohibits the Secretary from making these payments unless the territory has a plan approved by the Secretary to promptly distribute the payments to its residents.

Effective Date

The proposal is effective on the date of enactment of the bill.

PART IV—DEPENDENT CARE ASSISTANCE

A. Refundability and Enhancement of Child and Dependent Care Tax Credit

Present Law

A taxpayer who maintains a household that includes one or more qualifying individuals may claim a nonrefundable credit against income tax liability for up to 35 percent of a limited amount of employment-related child and dependent care expenses.¹⁵⁶ For this purpose, employment-related child and dependent care expenses are expenses for household services and expenses for the care of a qualifying individual.¹⁵⁷ These expenses must be incurred to enable the taxpayer to be gainfully employed.

A taxpayer's employment-related child and dependent care expenses for which the credit is allowed are limited to \$3,000 if the taxpayer has one qualifying individual or \$6,000 if the taxpayer has two or more qualifying individuals.¹⁵⁸ Thus, the maximum credit is \$1,050 if there is one qualifying individual and \$2,100 if there are two or more qualifying individuals. Employment-related child and dependent care expenses generally cannot exceed the taxpayer's earned income.¹⁵⁹

The applicable dollar limit is reduced by any amount excluded from income under an employer-provided dependent care assistance program under section 129. The 35-percent credit rate is reduced, but not below 20 percent, by one percentage point for each \$2,000 (or fraction thereof) of AGI above \$15,000.¹⁶⁰ Thus, for taxpayers with AGI above \$43,000, the credit rate is 20 percent. The phaseout threshold and the amount of expenses eligible for the credit are not indexed for inflation.

Generally, a qualifying individual is (1) a dependent of the taxpayer under section 152 who is under the age of 13, or (2) a dependent or spouse of the taxpayer if the dependent or spouse is physically or mentally incapable of caring for himself or herself and shares the same principal place of abode with the taxpayer for over one half the year.¹⁶¹ Married taxpayers must file a joint return in order to claim the credit.

¹⁵⁶ Sec. 21.

¹⁵⁷ Sec. 21(b)(2). Expenses do not include amounts paid for a camp where a qualifying individual stays overnight.

¹⁵⁸ Sec. 21(c).

¹⁵⁹ Sec. 21(d). Earned income has the same definition as for purposes of the EITC. Treas. Reg. sec. 1.21-2(b)(3).

¹⁶⁰ Sec. 21(a).

¹⁶¹ Sec. 21(b)(1).

Description of Proposal

The proposal temporarily expands the child and dependent care tax credit for 2021.¹⁶² First, the proposal makes the credit refundable for a taxpayer who has a principal place of abode in the United States for more than one half of the taxable year.¹⁶³ In the case of a joint return, refundability is allowed if at least one spouse satisfies the principal place of abode requirement. Principal place of abode is determined as provided in section 32.¹⁶⁴

In addition, the proposal increases the maximum credit rate to 50 percent and increases the amount at which the maximum credit rate begins to phase down to \$125,000 (from \$15,000).¹⁶⁵ The limitation on employment-related child and dependent care expenses is increased to \$8,000 (from \$3,000) in the case of one qualifying individual and to \$16,000 (from \$6,000) if there are two or more qualifying individuals.¹⁶⁶ Thus, the maximum credit is \$4,000 if there is one qualifying individual and \$8,000 if there are two or more qualifying individuals.

The proposal applies a two-part phaseout to the 50-percent credit rate.¹⁶⁷ Under the first part, the 50-percent credit rate is reduced, but not below 20 percent, by one percentage point for each \$2,000 (or fraction thereof) of AGI above \$125,000. Under the second part, the 20-percent credit rate is reduced, but not below zero, by one percentage point for each \$2,000 (or fraction thereof) of AGI above \$400,000. Thus, for taxpayers with AGI between \$183,000 and \$400,000, the credit rate is 20 percent and, for taxpayers with AGI above \$438,000, the credit is fully phased out. Figure 4 illustrates the credit amount by AGI for a taxpayer with one qualifying individual and for a taxpayer with two or more qualifying individuals, in each case assuming that the taxpayer has the maximum amount of employment-related child and dependent care expenses (\$8,000 and \$16,000, respectively).¹⁶⁸

¹⁶² Proposed sec. 21(g). The proposal applies for taxable years beginning in 2021.

¹⁶³ Proposed sec. 21(g)(1).

¹⁶⁴ Thus, a member of the Armed Forces of the United States stationed outside the United States while serving on extended active duty is treated as having a principal place of abode in the United States.

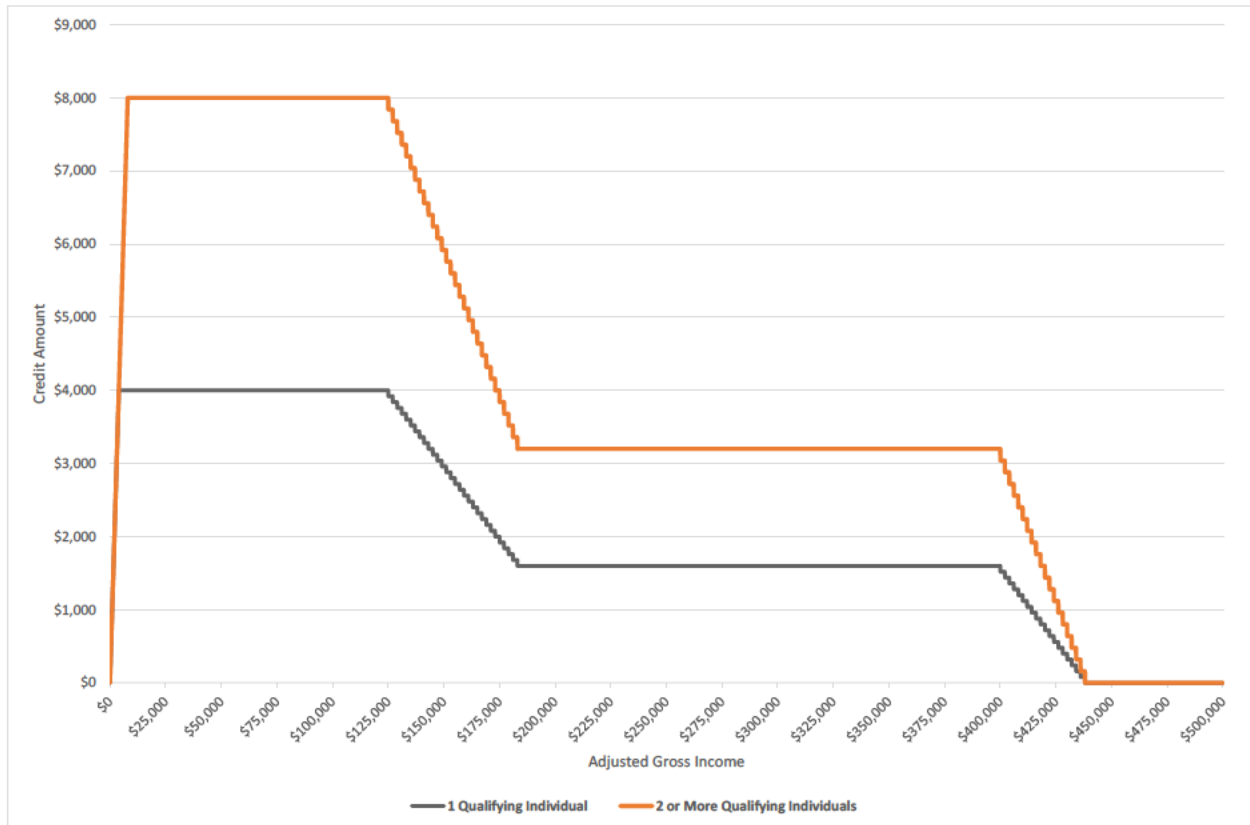
¹⁶⁵ Proposed sec. 21(g)(3).

¹⁶⁶ Proposed sec. 21(g)(2).

¹⁶⁷ Proposed sec. 21(g)(4).

¹⁶⁸ Figure assumes AGI and earned income are equal for these taxpayers.

**Figure 4.—Proposed Child and Dependent Care Tax Credit for 2021
by AGI for Selected Taxpayers**



Treatment of the U.S. territories

Under the proposal, the Secretary is directed to make payments for 2021¹⁶⁹ to each mirror Code territory (Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands) that relate to the cost to that territory of the child and dependent care tax credit. The Secretary is further directed to make similar payments for 2021 to each non-mirror Code territory (American Samoa and Puerto Rico).

The proposal directs the Secretary to pay to each mirror Code territory amounts equal to the aggregate amount of the credits allowable by reason of the application of the proposal. This amount is determined by the Secretary based on information provided by the government of the territory.¹⁷⁰

The proposal directs the Secretary to pay to each non-mirror Code territories amounts estimated by the Secretary as being equal to the aggregate benefits that would have been provided to the residents of the territory from the proposal if a mirror Code tax system had been

¹⁶⁹ The proposal applies for taxable years beginning in 2021.

¹⁷⁰ Prop. Sec. 21(h)(1).

in effect in the territory.¹⁷¹ The proposal prohibits the Secretary from making these payments unless the territory has a plan approved by the Secretary to promptly distribute the payments to its residents.

No credit against U.S. income taxes is permitted under the proposal for any person to whom a credit is allowed against territory income taxes as a result of the proposal (*i.e.*, under that territory's mirror Code).¹⁷² Similarly, no credit against U.S. income taxes is permitted for any person who is eligible for a payment under a non-mirror Code territory's plan for distributing to its residents the payment described above from the Secretary.

Effective Date

The proposal applies to taxable years beginning after December 31, 2020.

¹⁷¹ Prop. Sec. 21(h)(2).

¹⁷² Prop. Sec. 21(h)(3).

B. Employer-Provided Dependent Care Assistance

Present Law

An annual exclusion¹⁷³ from the gross income of an employee is allowed for employer-provided dependent care assistance in an amount up to \$5,000 (\$2,500 in the case of a separate return by a married individual) if such assistance is provided pursuant to a “dependent care assistance program.” Among other requirements, a dependent care assistance program¹⁷⁴ must be a separate written plan of an employer for the exclusive benefit of the employer’s employees to provide such employees with dependent care assistance that does not discriminate in favor of highly compensated employees or their dependents as to contributions, benefits, and eligibility.¹⁷⁵

The amount excludable for any taxable year cannot exceed the earned income of the employee or, if the employee is married, the lesser of the earned income of the employee or the earned income of the employee’s spouse.¹⁷⁶

Amounts attributable to dependent care assistance that are excludible from gross income are also excludible from wages for employment tax purposes.¹⁷⁷

A dependent care assistance program may be structured to allow contributions on a pre-tax basis through a cafeteria plan.¹⁷⁸ A cafeteria plan is a written plan maintained by an employer whereby all participants are employees who may choose among two or more benefits including qualified benefits and cash.¹⁷⁹ Qualified benefits provided under a cafeteria plan include dependent care assistance.

Description of Proposal

The proposal temporarily increases, for any taxable year beginning in 2021, the amount of the exclusion for employer-provided dependent care assistance. The provision increases such

¹⁷³ Sec. 129(a).

¹⁷⁴ Sec. 129(d).

¹⁷⁵ Sec. 129(d)(2) and (3). The exclusion applies if the contributions or benefits under the program do not discriminate in favor of highly compensated employees, within the meaning of section 414(q), or their dependents, and the program benefits employees under a classification established by the employer found not to be discriminatory in favor of such highly compensated employees or their dependents.

¹⁷⁶ Sec. 129(b). The provisions of section 21(d)(2) apply in determining the earned income of a spouse who is a student or incapable of caring for himself. Sec. 129(b)(2).

¹⁷⁷ Secs. 3401(b)(18), 3121(a)(18), 3306(b)(14).

¹⁷⁸ Sec. 125.

¹⁷⁹ Sec. 125(d).

amount from \$5,000 to \$10,500 (and half of such dollar amount in the case of a separate return by a married individual).

The proposal also provides that a plan that otherwise satisfies the requirements of a dependent care assistance program and cafeteria plan shall not fail to meet those requirements if the plan is amended to satisfy this proposal and the amendment is retroactive if the following are satisfied: (1) the amendment is adopted no later than the last day of the plan year in which the amendment is effective; and (2) the plan is operated consistently with the amendment terms beginning on the effective date of the amendment and ending on the date the amendment is adopted.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2020.

TITLE V—CREDITS FOR PAID SICK AND FAMILY LEAVE

A. Extension of Credits and Other Modifications

Present Law

The Families First Coronavirus Response Act (“FFCRA”)¹⁸⁰ required certain employers with fewer than 500 employees to provide paid sick and expanded family and medical leave to employees unable to work or telework for specified reasons related to COVID-19. The paid sick leave requirements in the Emergency Paid Sick Leave Act,¹⁸¹ and the expanded family and medical leave requirements in the Emergency Family and Medical Leave Expansion Act,¹⁸² expired on December 31, 2020.

Paid sick leave and paid expanded family and medical leave: employees

An employer is allowed a credit against the Old-Age, Survivors and Disability Insurance (“OASDI”) tax¹⁸³ or the equivalent amount of tax under the Railroad Retirement Tax Act (“RRTA”) imposed on the employer for each calendar quarter in an amount equal to 100 percent of the qualified sick leave wages and qualified family leave wages paid by the employer with respect to that calendar quarter, subject to limitations.¹⁸⁴ Qualified sick leave wages are defined as wages¹⁸⁵ and compensation¹⁸⁶ paid by an employer which are required to be paid by reason of the Emergency Paid Sick Leave Act. Qualified sick leave wages also generally include wages and compensation that would have been required to be paid if the Emergency Paid Sick Leave Act had been effective until March 31, 2021.¹⁸⁷

¹⁸⁰ Pub. .L. No. 116-127, 134 Stat. 178 (March 18, 2020).

¹⁸¹ Division E, FFCRA, Pub. .L. No. 116-127.

¹⁸² Division C, FFCRA, Pub. .L. No. 116-127.

¹⁸³ The Federal Insurance Contributions Act (“FICA”) imposes taxes on “wages,” as defined in Section 3121(a), with respect to “employment,” as defined in Section 3121(b). The term wages is defined for FICA purposes as all remuneration for employment, with certain specific exceptions. Employment is defined as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions. FICA taxes consist of the OASDI tax and the HI tax. HI tax includes an employer’s share imposed on wages at a rate of 1.45 percent under Section 3111(b). The employee’s share of HI tax is imposed on wages at a rate of 1.45 percent under Section 3101(b). Unlike OASDI, there is no contribution limit on wages subject to HI tax.

¹⁸⁴ IRS Notice 2020-21.

¹⁸⁵ Sec. 3121(a).

¹⁸⁶ Sec. 3231(e).

¹⁸⁷ Sec. 7001 of Pub. L. No. 116-127, as amended by the CAA, Pub. L. No. 116-260, sec. 286.

Qualified family leave wages are wages¹⁸⁸ and compensation¹⁸⁹ paid by an employer which are required to be paid by reason of the Emergency Family and Medical Leave Expansion Act.¹⁹⁰ Qualified family leave wages also generally include wages and compensation that would have been required to be paid if the Emergency Family and Medical Leave Expansion Act had been effective until March 31, 2021.¹⁹¹ In addition to qualified sick leave wages and qualified family leave wages, the credit could be increased by certain health plan expenses of the employer.

Amount of credit for paid sick leave

Certain employers must provide an employee with up to 80 hours of paid sick time to the extent that (1) the employee is subject to a Federal, State, or local quarantine or isolation order related to COVID-19; (2) the employee has been advised by a health care provider to self-quarantine due to concerns related to COVID-19; (3) the employee is experiencing symptoms of COVID-19 and is seeking a medical diagnosis; (4) the employee is caring for an individual who is subject to a quarantine or isolation order or has been advised by a health care provider to self-quarantine; (5) the employee is caring for the employee's son or daughter if the school or place of care of the son or daughter has been closed, or the child care provider of such son or daughter is unavailable due to COVID-19 precautions; or (6) the employee is experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretary of Treasury and the Secretary of Labor.¹⁹²

The amount of qualified sick leave wages that may be taken into account for an employee for purposes of the credit is limited based on the circumstances under which qualified sick leave wages are paid. In the case of paid sick time qualifying under categories (1), (2), or (3) above, the amount of qualified sick leave wages taken into account for purposes of the credit may not exceed \$511 for any day (or portion thereof) when the individual is paid such sick time. In the case of paid sick time qualifying under categories (4), (5), or (6) above, the amount of qualified sick leave wages taken into account may not exceed \$200 for any day (or portion thereof) for which the individual is paid such sick time. In addition, the aggregate number of days that may be taken into account with respect to an individual under all six circumstances may not exceed the excess (if any) of 10 days over the aggregate number of days taken into account for all preceding calendar quarters.

Amount of credit for expanded family and medical leave

Certain employers must provide public health emergency leave to employees under the Family and Medical Leave Act of 1993 ("FMLA"), as amended by the Emergency Family and

¹⁸⁸ Sec. 3121(a).

¹⁸⁹ Sec. 3231(e).

¹⁹⁰ See IRS Notice 2020-54.

¹⁹¹ Sec. 7001 of Pub. L. No. 116-127, as amended by the CAA, Pub. L. No. 116-260, sec. 286.

¹⁹² Sec. 5102(a), Division E, FFCRA, Pub. L. No. 116-127.

Medical Leave Expansion Act.¹⁹³ This requirement generally applies when an employee is unable to work or telework due to a need for leave to care for a son or daughter under age 18 because the school or place of care has been closed, or the child care provider is unavailable, due to a public health emergency. An employer with employees who are health care providers or emergency responders may elect to exclude such employees from this requirement to provide paid family leave. A public health emergency for this purpose is an emergency with respect to COVID-19 declared by a Federal, State, or local authority.

The first 10 days of public health emergency leave required under the Emergency Family and Medical Leave Expansion Act may consist of unpaid leave, after which paid leave is required for ten weeks until December 31, 2020. The amount of required paid leave is calculated based on: (a) an amount that is not less than two-thirds of an employee's regular rate of pay; and (b) the number of hours the employee would otherwise be normally scheduled to work. The paid leave mandated by the Emergency Family and Medical Leave Expansion Act does not exceed \$200 per day and \$10,000 in the aggregate.

Employers are allowed a credit against OASDI taxes or the equivalent amount of RRTA taxes in an amount equal to 100 percent of qualified family leave wages paid by the employer during the quarter. Consistent with the mandate, the maximum amount of the qualified family leave wages eligible for the credit is \$200 for any day (or portion thereof) for which the employee is paid qualified family leave wages, and in the aggregate with respect to all quarters, \$10,000.¹⁹⁴ Employers are not allowed the credit in respect of unpaid leave.

Additional rules

The credit allowed for paid sick or paid family leave is increased by the employer's qualified health plan expenses as are properly allocable to the qualified sick leave wages for which the credit is allowed. Qualified health plan expenses are amounts paid or incurred by the employer to provide and maintain a group health plan,¹⁹⁵ but only to the extent such amounts are excluded from the employees' income as coverage under an accident or health plan.¹⁹⁶ Qualified health plan expenses are allocated to qualified sick leave wages in such manner as the Secretary of Treasury (or the Secretary's delegate) may prescribe.¹⁹⁷ Except as otherwise provided by the Secretary, such allocations are treated as properly made if they are pro rata among covered

¹⁹³ Sec. 3102, Division C, FFCRA, Pub. L. No. 116-127.

¹⁹⁴ Sec. 287 of the CAA, Pub. L. No. 116-260, provides that self-employed individuals may make an election to use prior year net earnings from self-employment in determining the average daily self-employment income for purposes of credits for paid sick and family leave.

¹⁹⁵ Sec. 5000(b)(1).

¹⁹⁶ Sec. 106(a).

¹⁹⁷ See IRS FAQs, <https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-amount-of-allocable-qualified-health-plan-expenses-faqs#determining-amount-allocable-qualified-health-plan-expenses> (Jan 7, 2021).

employees and pro rata on the basis of periods of coverage (relative to the time periods of leave to which such wages relate).

The credit allowed may not exceed the OASDI tax or equivalent amount of RRTA tax imposed on the employer, reduced by any credits allowed for the employment of qualified veterans¹⁹⁸ and research expenditures of qualified small businesses¹⁹⁹ for that calendar quarter on the wages paid with respect to all the employer's employees. However, if for any calendar quarter the amount of the credit exceeds the OASDI tax or RRTA tax imposed on the employer, reduced as described in the prior sentence, such excess is treated as a refundable overpayment.²⁰⁰

If a taxpayer claims a credit, the amount so claimed is included in gross income. Thus, the credit is not taken into account for purposes of determining any amount allowable as a payroll tax deduction or deduction for qualified sick leave wages or qualified family leave wages (or any amount capitalizable to basis).

Any qualified sick leave wages taken into account for purposes of a credit are not taken into account for purposes of determining the section 45S general business credit for employer paid family and medical leave. Thus, the employer may not claim a credit under section 45S with respect to the qualified sick leave wages or qualified family leave wages paid but may be allowed a credit under section 45S with respect to any additional wages paid.

An employer may elect not to claim a tax credit for a calendar quarter for qualified sick leave wages or qualified family leave wages. Further, the credit allowed does not apply to the government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any of those entities. Employers in the U.S. territories may claim the credit by filing their quarterly Federal employment tax returns.

Any wages or compensation required to be paid to employees pursuant to the Emergency Paid Sick Leave Act or Emergency Family and Medical Leave Expansion Act before December 31, 2020, are not considered wages for purposes of OASDI tax or compensation for purposes of RRTA tax. In addition, or, in the case of wages or compensation paid after December 31, 2020 and before April 1, 2021, any wages or compensation with respect to which a credit is allowed, are not considered wages for purposes of OASDI tax or compensation for purposes of RRTA tax. As a result, no taxes are collected on these amounts from employers or employees.²⁰¹

¹⁹⁸ Sec. 3111(e).

¹⁹⁹ Sec. 3111(f).

²⁰⁰ The excess is treated as an overpayment and refunded under sections 6402(a) and 6413(b). In addition, any amount that is due to an employer is treated in the same manner as a refund due from a credit provision. 31 U.S.C. 1324. Thus, amounts are appropriated to the Secretary of Treasury for refunding such excess amounts.

²⁰¹ An amount equal to the reduction in revenues to the Treasury by reason of the FFCRA is appropriated to the OASDI Trust Funds and the Social Security Equivalent Benefit Account established under the Railroad Retirement Act of 1974.²⁰¹ This amount is transferred from the general fund at such times and in such manner as to replicate to the extent possible the transfers that would have occurred to the OASDI Trust Funds or Social Security Equivalent Benefit Account had this provision not been enacted.

Paid sick leave and expanded family and medical leave: self-employed individuals

An eligible self-employed individual may claim an income tax credit for any taxable year for a qualified sick leave equivalent amount or qualified family leave equivalent amount. An eligible self-employed individual is defined as an individual who regularly carries on any trade or business²⁰² and who would be entitled to receive paid leave during the taxable year under the Emergency Paid Sick Leave Act or Emergency Family and Medical Leave Expansion Act, if the individual were an employee of an employer (other than himself or herself) that would be subject to the requirements of the Acts and as if the Acts were in effect through March 31, 2021.

The qualified sick leave equivalent amount with respect to an eligible self-employed individual is an amount equal to the number of days during the taxable year that the self-employed individual cannot perform services for which that individual would have been entitled to sick leave pursuant to the Emergency Paid Sick Leave Act²⁰³ (if the individual were employed by an employer), multiplied by the lesser of two amounts: (1) \$511 in the case of paid sick time described in categories (1), (2), or (3) above with respect to section 5102(a) of the Emergency Paid Sick Leave Act (\$200 in the case of paid sick time described in categories (4), (5), or (6) above); or (2) 100 percent of the average daily self-employment income of the individual for the taxable year in the case of any day of paid sick time described in categories (1), (2), or (3) above (67 percent in the case of paid sick time described in categories (4), (5), or (6) above).

The number of days taken into account in determining the qualified sick leave equivalent amount may not exceed, with respect to any taxable year, 10 days, taking into account any days taken in all preceding taxable years. The individual's average daily self-employment income under the provision is an amount equal to the net earnings from self-employment for the taxable year divided by 260.

If an eligible self-employed individual receives qualified sick leave wages,²⁰⁴ the individual's qualified sick leave equivalent amount determined under the provision is reduced (but not below zero) to the extent that the sum of the qualified sick leave equivalent amount and the qualified sick leave wages received exceeds \$2,000 (\$5,110 in the case of any day any portion of which is paid sick time described in category (1), (2), or (3) above).

The qualified family leave equivalent amount with respect to an eligible self-employed individual is an amount equal to the number of days (up to 50) during the taxable year that the self-employed individual cannot perform services for which that individual would be entitled to paid leave pursuant to the Emergency Family and Medical Leave Expansion Act²⁰⁵ (if the individual were employed by an employer), multiplied by the lesser of two amounts: (1) 67 percent of the average daily self-employment income of the individual for the taxable year, or (2)

²⁰² Within the meaning of sec. 1402.

²⁰³ Division E and C, FFCRA, Pub. L. No. 116-127.

²⁰⁴ As defined by sec. 7001(c) of FFCRA, Pub. L. No. 116-127.

²⁰⁵ Division C, FFCRA, Pub. L. No. 116-127.

\$200. The individual's average daily self-employment income under the provision is an amount equal to the individual's net earnings from self-employment for the year divided by 260.

The credit allowed for the qualified sick leave equivalent amount or qualified family leave equivalent amount is applied against federal income taxes and is a refundable credit.²⁰⁶

If an eligible self-employed individual receives qualified family leave wages,²⁰⁷ the individual's qualified family leave equivalent amount determined under the provision is reduced (but not below zero) to the extent that the sum of the qualified family leave equivalent amount and the qualified family leave wages received exceeds \$10,000.

Application of credit in certain territories

The Secretary of Treasury is directed to make payments to each territory with a mirror Code tax system that relate to the cost (if any) of each territory's credits for sick leave or expanded family and medical leave for certain self-employed individuals. The Secretary is further directed to make similar payments to each non-mirror Code territory.

With respect to mirror Code territories, the Secretary is required to make payments equal to the loss in revenue by reason of the application of the credit for sick leave or expanded family and medical leave for certain self-employed individuals to the territory's mirror Code. This amount is determined by the Secretary based on information provided by the governments of the respective territories.

With respect to Puerto Rico and American Samoa (non-mirror Code territories), the Secretary is directed to make payments in an amount estimated by the Secretary as being equal to the aggregate benefits that would have been provided to the residents of each territory from the credit for sick leave or expanded family and medical leave for certain self-employed individuals if a mirror Code tax system had been in effect in such territory. The Secretary must not make these payments unless the territory has a plan approved by the Secretary to promptly distribute the payments to its residents.

The Secretary of Treasury is directed to prescribe such regulations or other guidance as may be necessary to carry out the purposes of the provision, including (1) to effectuate the purposes of this Act, and (2) to minimize compliance and record-keeping burdens under the provision.

²⁰⁶ Any refund due to an individual is treated in the same manner as a refund due from a credit provision. 31 U.S.C. sec. 1324. Thus, amounts are appropriated to the Secretary (or the Secretary's delegate) for refunding such amounts.

²⁰⁷ As defined by sec. 7003(c) of the FFCRA, Pub. L. No. 116-127.

Description of Proposal

Extension of credits

The proposal extends the credit for qualified sick leave wages, qualified sick leave equivalent amount, qualified family leave wages, and qualified family leave equivalent amount by two calendar quarters until October 1, 2021.

Increase in limitations on credits for paid family leave

The proposal increases the amount of qualified family leave wages that may be used for purposes of calculating a credit. The amount of qualified leave wages taken into account with respect to an individual may not exceed \$200 for any day for which the individual is paid qualified family leave wages, or \$12,000 (increased from \$10,000 under present law) in the aggregate with respect to all calendar quarters.

As a conforming amendment, the proposal addresses the denial of double benefit for self-employed individuals. In the case of an individual who receives wages²⁰⁸ or compensation²⁰⁹ paid by an employer consistent with the terms of the Emergency Family and Medical Leave Expansion Act, the qualified family leave equivalent amount is reduced (but not below zero) to the extent the sum of the amount and qualified leave wages exceeds \$12,000 (increased from \$10,000 under present law).

The proposal also increases the qualified family leave equivalent amount for self-employed individuals. The term “qualified family leave equivalent amount” with respect to a self-employed individual is an amount equal to the product of: (1) the number of days not to exceed 60 (increased from 50 under present law) during the taxable year that the individual is unable to perform services in any trade or business referred to in section 1402 for a reason with respect to which such individual would be entitled to receive paid leave, multiplied by; (2) the lesser of 67 percent of the average daily self-employment income of the individual for the taxable year, or \$200.

The proposal amends the definition of qualified family leave wages by adding that, in part, such wages are those which would be required to be paid pursuant to FMLA, as amended by the Emergency Family and Medical Leave Expansion Act, if it were applied by substituting September 30, 2021 for December 31, 2020 and if the maximum wages were applied by substituting \$12,000 for \$10,000. In addition, the proposal amends the definition of qualified family leave wages by providing that such wages include those which would be required to be paid for any reason described in the six categories previously outlined that apply for purposes of eligibility for paid family leave.²¹⁰

²⁰⁸ Sec. 3121(a).

²⁰⁹ Sec. 3231(e).

²¹⁰ Section 5102(a) of Division E, FFCRA, Pub. L. No. 116-127.

Paid leave credits allowed for COVID-19 vaccination

The proposal expands the definition of qualified sick leave wages and qualified family leave wages to include time the employee is unable to work (or telework) because the employee is obtaining immunization related to COVID-19 or is recovering from any injury, disability, illness, or condition related to such immunization.

Application of non-discrimination rules

The proposal adds a restriction that no credit is allowed for qualified sick leave wages or qualified family leave wages if, in the provision of qualified sick leave wages or qualified family leave wages, the employer discriminates in favor of highly compensated employees,²¹¹ full-time employees, or employees on the basis of employment tenure with the employer.

Reset of limitation on paid sick leave

The proposal amends the overall limitation on the number of days that may be taken into account for purposes of the payroll credit for paid sick leave. For calendar quarters beginning after March 31, 2021, the aggregate number of days that may be taken into account for paid sick leave may not exceed the excess (if any) of 10 over the aggregate number of days so taken into account in the preceding calendar quarters in such calendar year (other than the first quarter of calendar year 2021). Before the second quarter of 2021 (starting April 1, 2021), the aggregate number of days taken into account for any calendar quarter may not exceed the excess (if any) of 10 over the aggregate number of days so taken into account for all preceding calendar quarters. The determination of the amount of paid sick time paid to an employee and remuneration counted as qualified sick leave wages are determined on a calendar year basis.²¹² The same rule applies to paid sick leave for self-employed individuals and the number of days that may be taken into account for purposes of calculating the qualified sick leave equivalent amount. The proposal also coordinates these changes with Divisions C and E of the FFCRA.

Credits allowed against employer Hospital Insurance (“HI”) tax

The proposal replaces the credit against OASDI tax and the equivalent amount of RRTA tax with a credit against HI tax and the equivalent amount of RRTA tax.²¹³ The refundable credit against HI tax and the equivalent amount of RRTA tax applies to qualified sick leave

²¹¹ Sec. 414(q).

²¹² Section 5102 of the FFCRA provides that the amount of paid sick time to which an employee is entitled shall be 80 hours for full-time employees. For part-time employees, the maximum amount of paid sick leave is number of hours equal to the number of hours that such employee works, on average, over a two-week period.

²¹³ The proposal does not include express language that “holds harmless” the Federal Hospital Insurance Trust Fund from any effects of the proposal. Under current law, amounts are appropriated and transferred to the trust fund include amounts equivalent to 100% of the taxes imposed by section 3111(b) with respect to applicable wages reported by the Secretary, determined by applying the rate to the reported wages. Sec. 1807 of the Social Security Act, 42 U.S.C. sec. 1395i. Because the proposal does not affect either the rate under section 3111(b) or applicable wages, but only provides a credit against the amount of tax, the proposal does not affect the trust fund, and no hold harmless language is needed.

wages and qualified family leave wages paid after March 31, 2021 and before October 1, 2021, with respect to which a credit is allowed. The credit for the qualified sick leave equivalent amount and qualified family leave equivalent amount is also extended to October 1, 2021.

Application of credits to certain governmental employers

The proposal provides that a credit is not allowed for paid sick leave or paid family leave for the U.S. government or any agency or instrumentality thereof with the exception of an organization described in section 501(c)(1) of the Code that is exempt from tax under section 501(a) of the Code. State governments and political subdivisions thereof are now eligible for the credit, whereas such entities were previously ineligible.

Gross up of credit in lieu of exclusion from tax

The proposal increases the credits for qualified sick leave wages and qualified family leave wages by the amount of the OASDI and HI taxes, and the equivalent portions of RRTA tax, respectively, on qualified sick leave wages and qualified family leave wages, for which a credit is allowed. The denial of a double benefit also applies to the increase in the amount of credits as described in the preceding sentence. Under this rule, the gross income of the employer, for purposes of chapter 1 of the Code, is increased by the amount of the credit. Any wages taken into account in determining the credits for paid sick or paid family leave shall not be taken into account for purposes of the determining the employer's general business credit for paid family leave.²¹⁴

Effective Date

The proposal is generally effective for amounts paid after March 31, 2021. The proposal is effective for purposes of the paid sick leave credit for self-employed individuals for taxable years beginning after December 31, 2020.

²¹⁴ Sec. 45S.

PART VI—EMPLOYEE RETENTION CREDIT

A. Extension of the Employee Retention Credit

Present Law

In general

Federal employment taxes and OASDI and HI Trust Funds

Federal employment taxes are imposed on wages paid to employees with respect to employment and include taxes levied under the Federal Insurance Contributions Act (“FICA”), the Federal Unemployment Tax Act (“FUTA”), and Federal income tax.²¹⁵ In addition, tier 1 of the RRTA imposes a tax on compensation paid to railroad employees and representatives.²¹⁶

FICA taxes are comprised of two components: OASDI taxes and HI taxes. With respect to OASDI taxes, the applicable rate is 12.4 percent with half of such rate (6.2 percent) imposed on the employee and the remainder (6.2 percent) imposed on the employer.²¹⁷ The tax is assessed on covered wages up to the OASDI wage base (\$137,700 in 2020). Generally, the OASDI wage base rises based on increases in the national average wage index.²¹⁸

The HI tax has two components: Medicare tax and Additional Medicare tax. Medicare tax is imposed on wages, as defined in section 3121(a), with respect to employment, as defined in section 3121(b), at a rate of 1.45 percent for the employer.²¹⁹ An equivalent 1.45 percent is withheld from employee wages.²²⁰ Additional Medicare taxes are withheld from employee wages in excess of \$200,000 at a rate of 0.9 percent.²²¹ There is no equivalent employer’s share of Additional Medicare taxes. For purposes of this description, HI tax does not include Additional Medicare tax.

The employee portion of OASDI taxes must be withheld and remitted to the Federal government by the employer during the calendar quarter, as required by the applicable deposit rules.²²² The employer is liable for the employee portion of OASDI taxes, in addition to its own

²¹⁵ Secs. 3101, 3111, 3301, and 3401.

²¹⁶ Sec. 3221.

²¹⁷ Sec. 3101.

²¹⁸ Sec. 230 of the Social Security Act (42 U.S.C. sec. 430).

²¹⁹ Sec. 3111(b)(1).

²²⁰ Sec. 3101(b)(1).

²²¹ Sec. 3101(b)(2).

²²² Sec. 3102(a) and Treas. Reg. sec. 31.3121(a)-2. See also sec. 6302.

share, whether or not the employer withholds the amount from the employee's wages.²²³ OASDI and HI taxes are generally allocated by statute among separate trust funds: the OASDI Trust Funds, Medicare's Hospital Insurance Trust Fund, and Supplementary Medical Insurance Trust Fund.²²⁴

Generally, the term "wages" for OASDI tax purposes means all remuneration for "employment," including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain exceptions.²²⁵ The name given to the remuneration for employment is immaterial. OASDI wages includes salaries, vacation allowances, bonuses, deferred compensation, commissions, and fringe benefits. The term "employment" is generally defined for FICA tax purposes as any service, of whatever nature, performed by an employee for the person employing him or her, with certain specific exceptions.

Railroad retirement program

Railroad workers do not participate in the OASDI system. Compensation subject to RRTA tax is exempt from FICA taxes.²²⁶ The RRTA imposes a tax on compensation paid by covered employers to employees in recognition for the performance of services.²²⁷ The term "compensation" means any form of money remuneration paid to an individual for services rendered as an employee to one or more employers, with certain exceptions.²²⁸ Employees whose compensation is subject to RRTA tax are generally eligible for railroad retirement benefits under a two-tier structure. Rail employees and employers pay tier 1 taxes at the same rate as other employment taxes.²²⁹ In addition, rail employees and employers both pay tier 2 taxes, which are used to finance railroad retirement benefits above Social Security benefit levels.²³⁰ Tier 2 benefits are similar to a private defined benefit pension.

²²³ Sec. 3102(b).

²²⁴ Secs. 201 and 1817 of the Social Security Act, Pub. L. No. 74-271 as amended (42 U.S.C. secs. 401 and 1395i).

²²⁵ Sec. 3121(a).

²²⁶ Sec. 3121(b)(9).

²²⁷ Secs. 3201 through 3233. Instead of FICA taxes, railroad employers and employees are subject, under the RRTA, to taxes equivalent to the OASDI and HI taxes under FICA. Under the RRTA, employers and employees are also subject to an additional tax, referred to as the "tier 2" tax, on compensation up to a certain amount.

²²⁸ Sec. 3231(e).

²²⁹ 7.65 percent, consisting of 6.2 percent for retirement on earnings up to \$137,700 in 2020, and 1.45 percent for Medicare hospital insurance on all earnings. An additional 0.9 percent in Medicare taxes are withheld from employees on earnings above \$200,000.

²³⁰ In 2020, the tier 2 tax rate on earnings up to \$102,300 is 4.9 percent for employees and 13.1 percent for employers.

Employment tax in the U.S. territories

Employers and employees in the U.S. territories are generally subject to FICA payroll tax obligations.²³¹ In contrast, employers and employees in the territories are generally not subject to withholding at the source for Federal income tax, although they are subject to withholding of local taxes.²³² These payroll obligations of the employers are generally applicable to Federal agencies with personnel in the territory. Employers in the territories file quarterly tax returns with the Federal government to report and pay FICA taxes for employees in the respective territories.

Employee retention credits against income taxes

Congress has at times enacted employee retention credits against employer income tax in response to natural disasters.²³³ These enactments generally provide a credit of 40 percent of the wages (up to a maximum of \$6,000 in wages per employee) paid by certain employers harmed by the applicable disaster to employees employed in the applicable disaster zone during the period when the employer's business was inoperable due to the applicable disaster. The credits are treated as a current year business credit under section 38(b) and therefore subject to the Federal income tax liability limitations of section 38(c). Rules similar to those in sections 51(i)(1), 52, and 280C(a) apply to the credits.²³⁴

Employee retention tax credit included in the CARES Act

In general

Section 2301 of the CARES Act, Public Law 116-136, allows an eligible employer to claim a credit against applicable employment taxes for each calendar quarter in an amount equal to 50 percent of the qualified wages with respect to each employee of such employer for such calendar quarter. Applicable employment taxes are OASDI tax²³⁵ imposed on the employer and

²³¹ See sec. 3121(b) and (e) and Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, Sec. 601(c). The U.S. territories referred to in this document are American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, and the U.S. Virgin Islands.

²³² Under section 3401(a)(8), most wages paid to U.S. persons for services performed in one of the territories are exempt from Federal income tax withholding if the payments are subject to withholding by the territory, or, in the case of Puerto Rico, the payee is a bona fide resident of the territory for the full year.

²³³ See, e.g., sec. 203 of Pub. L. No. 116-94, Div. Q (providing a credit in response to certain major disasters declared in 2018 and 2019); sec. 20103 of Pub. L. No. 115-123 (providing a credit in response to 2017 California wildfires); sec. 503 of Pub. L. No. 115-63, as amended by sec. 20201(b) of Pub. L. No. 115-123 (providing a credit in response to Hurricanes Harvey, Irma, and Maria); and former sec. 1400R (providing a credit in response to Hurricanes Katrina, Rita, and Wilma).

²³⁴ For a more detailed description of the most recently enacted employee retention credit (related to certain major disasters declared in 2018 and 2019), see Joint Committee on Taxation, *Description of H.R. 3301, The Taxpayer Certainty and Disaster Tax Relief Act of 2019* (JCX-30-19), June 2019 pp. 80-81.

²³⁵ Sec. 3111(a).

the equivalent rate for RRTA tax²³⁶ imposed on the employer. The amount of qualified wages with respect to an employee which may be taken into account in calculating the credit for all calendar quarters may not exceed \$10,000. Therefore, the maximum amount of credit per employee for all calendar quarters is \$5,000. The credit applies only to wages paid after March 12, 2020 and before January 1, 2021.

The credit allowed may not exceed the applicable employment taxes imposed on the eligible employer for that calendar quarter on the wages paid with respect to all of the employer's employees, reduced by any credits allowed for the employment of qualified veterans,²³⁷ for research expenditures of a qualified small business,²³⁸ or for paid sick or family leave under sections 7001 and 7003 of the FFCRA.²³⁹ However, if for any calendar quarter the amount of the credit exceeds the applicable employment taxes imposed on the employer, reduced as described in the prior sentence, such excess is treated as a refundable overpayment.²⁴⁰

For example, assume that, for a calendar quarter, an eligible employer had applicable employment taxes prior to any credits of \$10,000 and (1) a credit for research expenditures of a qualified small business of \$4,000, (2) a \$3,000 credit for paid sick leave under section 7001 of the FFCRA, and (3) a \$5,000 employee retention credit. The eligible employer's applicable employment taxes are reduced to \$0 and it has a \$2,000 refundable overpayment.²⁴¹ If, instead, the eligible employer had applicable employment taxes prior to any credits of \$2,000, its applicable employment taxes are reduced to \$0 and it has an \$8,000 refundable overpayment.²⁴²

Definition of eligible employer

An eligible employer is any employer which was carrying on a trade or business during calendar year 2020 and which meets either of two tests.

Under the first test (the "governmental order test"), such employer is an eligible employer if it experiences a calendar quarter in which the operation of the trade or business is fully or

²³⁶ Sec. 3221(a).

²³⁷ This credit is described in section 3111(e).

²³⁸ This credit is described in section 3111(f).

²³⁹ Pub. L. No. 116-127, as amended by the CAA, Pub. L. No. 116-260.

²⁴⁰ The excess is treated as an overpayment and refunded under sections 6402(a) and 6413(b). For purposes of section 1324 of Title 31, United States Code, any amount due to an employer is treated in the same manner as a refund due from the credits against applicable employment taxes described above. Thus, pursuant to that section, amounts are appropriated to the Secretary for refunding such excess amounts.

²⁴¹ The tax is reduced by the \$4,000 research expenditures credit, the \$3,000 paid sick leave credit, and \$3,000 of the \$5,000 employee retention credit. The \$2,000 excess employee retention credit is treated as refundable.

²⁴² The tax is reduced by the \$2,000 research expenditures credit, the other \$2,000 of which is not refundable. See sec. 3111(f). The \$3,000 paid sick leave credit is treated as refundable, section 7001(b)(4) of the FFCRA, as is the \$5,000 employee retention credit.

partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.

For example, a restaurant in a State under a Statewide order that restaurants offer only take-out service meets the governmental order test, as does a concert venue in a State under a Statewide order limiting gatherings to no more than 10 people. Similarly, an accounting firm that is in a county where accounting firms are among businesses subject to a directive from public health authorities to cease all activities other than minimum basic operations and that closes its offices and does not require employees who cannot work from home (*e.g.*, custodial employees, mail room employees) to work meets this test. However, a grocery store in a State that generally imposes limitations on food service, gathering size, and travel outside the home, but exempts grocery stores (and travel to and from grocery stores) from any COVID-19 related restrictions (*e.g.*, because grocery stores are deemed an “essential business” that is excepted from restrictions) would not meet this test.

Under the second test (the “reduced gross receipts test”), such employer is an eligible employer if it experiences a significant decline in gross receipts. The employer is treated as experiencing a significant decline in gross receipts in the period (i) beginning with the first calendar quarter beginning after December 31, 2019, for which gross receipts (within the meaning of section 448(c)) for the calendar quarter are less than 50 percent of gross receipts for the same calendar quarter in the prior year, and (ii) ending with the quarter following the first calendar quarter beginning after a calendar quarter described in (i) in which gross receipts exceed 80 percent of gross receipts for the same calendar quarter for the prior year.

For example, if an employer had gross receipts of \$100 in each calendar quarter of 2019 and then had gross receipts in the first, second, third, and fourth quarters of 2020 of \$100, \$40, \$90, and \$100, respectively, the period in which such employer is treated as meeting the significant decline in gross receipts test is the second and third quarters of 2020.

An organization described in section 501(c) may qualify as an eligible employer under either test.²⁴³ The requirement that an eligible employer be carrying on a trade or business during calendar year 2020 and the governmental order test are to be applied as if they referred to all operations of such organization, and not merely those which are treated as a trade or business.

Definition of qualified wages

The definition of qualified wages depends on the average number of full-time and full-time-equivalent employees of the eligible employer during 2019.²⁴⁴ All persons treated as a

²⁴³ Section 206 of Division EE of the CAA clarifies this definition, as described below.

²⁴⁴ The metric is the “average number of full-time employees (within the meaning of section 4980H of the Internal Revenue Code of 1986).” This language includes full-time equivalents as referred to in section 4980H(c)(2)(E), which reads as follows:

(E) Full-time equivalents treated as full-time employees. Solely for purposes of determining whether an employer is an applicable large employer under this paragraph, an employer shall, in addition to the number of full-

single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414 are treated as one employer for purposes of the credit.

For an eligible employer that had more than 100 such employees in 2019, qualified wages are wages paid by the eligible employer with respect to which an employee is not providing services due to circumstances that cause the eligible employer to meet either the governmental order test or the reduced gross receipts test.

For example, if a restaurant that had an average of 150 full-time employees during 2019 meets the governmental order test, and the restaurant continues to pay kitchen employees' wages as if they were working 40 hours per week but only requires them to work 15 hours per week, the wages paid to the kitchen employees for the 25 hours per week with respect to which the kitchen employees are not providing services are qualified wages. However, if the same restaurant reduces kitchen employees' working hours from 40 hours per week to 15 hours per week and only pays wages for 15 hours per week, no wages paid to the kitchen employees are qualified wages.

As another example, if an accounting firm that had an average of 500 full-time employees during 2019 meets the governmental order test, and during the period in which the governmental order is in place the accounting firm closes its office and does not require custodial and mail room employees to work but continues to pay them their full salaries, wages paid to those custodial and mail room employees for the time they do not work are qualified wages. Similarly, if the accounting firm continues to pay administrative assistants their full salaries but only requires them to work two days per week on a rotating schedule reflecting reduced demand for assistance resulting from the office closure, the portion of an administrative assistant's salary attributable to days not worked are qualified wages.

Qualified wages paid to an employee by an eligible employer that had more than 100 full-time employees in 2019 cannot exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period in which the eligible employer met either the governmental order test or the reduced gross receipts test.

For example, if an eligible employer subject to this rule paid an employee \$15 per hour for all hours worked prior to meeting the governmental order test, but during the period when the eligible employer meets the governmental order test pays the same employee \$10 per hour for hours when the employee is providing services and \$20 per hour for hours when the employee is not providing services, only \$15 per hour of wages paid when the employee is not providing services are qualified wages. As another example, if an eligible employer subject to this rule paid an employee \$15 per hour for all hours worked prior to meeting the governmental order test, but during the period when the eligible employer meets the governmental order test pays the same employee \$20 per hour (both for hours when the employee is providing services and for

time employees for any month otherwise determined, include for such month a number of full-time employees determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120.

hours when the employee is not providing services), only \$15 per hour of wages paid when the employee is not providing services are qualified wages.

For an eligible employer that had an average of 100 or fewer full-time employees in 2019, qualified wages are wages paid to any employee either during the time period in which such eligible employer meets the governmental order test or during a quarter in which the eligible employer meets the reduced gross receipts test.

For example, if a restaurant that had an average of 45 full-time employees during 2019 meets the governmental order test, and the restaurant continues to pay kitchen employees' wages as if they were working 40 hours per week but only requires them to work 15 hours per week, all of such employees' wages paid during the period to which the governmental order applies are qualified wages. If the same restaurant responds to the governmental order by reducing the hours of kitchen employees who had previously worked 40 hours per week to 15 hours per week and only pays wages for 15 hours per week, such wages paid during the period to which the governmental order applies are qualified wages.

As another example, if a grocery store that had an average of 75 full-time employees during 2019 meets the reduced gross receipts test for the second and third calendar quarters of 2020, all wages paid by the grocery store during those quarters are qualified wages.

Qualified wages do not include any wages²⁴⁵ or compensation²⁴⁶ taken into account under sections 7001 or 7003 of the FFCRA. Qualified wages also include so much of the employer's qualified health plan expenses as are properly allocable to qualified wages under the credit. Qualified health plan expenses are defined as amounts paid or incurred by the employer to provide and maintain a group health plan,²⁴⁷ but only to the extent such amounts are excluded from the employees' income as coverage under an accident or health plan.²⁴⁸ Qualified health plan expenses are allocated to qualified wages in such manner as the Secretary (or the Secretary's delegate) may prescribe. Except as otherwise provided by the Secretary (or the Secretary's delegate), such allocations are treated as properly made if made pro rata among covered employees and pro rata on the basis of periods of coverage (relative to the time periods of leave to which such wages relate).²⁴⁹

²⁴⁵ Sec. 3121(a).

²⁴⁶ Sec. 3231(e).

²⁴⁷ Group health plan for this purpose is defined in section 5000(b)(1).

²⁴⁸ For the exclusion, see section 106(a).

²⁴⁹ Section 206 of Division EE of the CAA, Pub. L. No. 116-260, clarifies this definition, as described below.

Other rules, definitions, and guidance

No credit is available to any employer that receives a small business interruption loan (*i.e.*, a covered loan under paragraph (36) of section 7(a) of the Small Business Act (15 U.S.C. 636(a)) as added by section 1102 of the CARES Act).

If a taxpayer claims the credit, rules similar to the rules of sections 51(i)(1) and 280C(a) apply. Thus, for example, an employee retention credit may not be generated by an individual employer hiring his or her children. In addition, the credit is taken into account for purposes of determining any amount allowable as an income tax deduction for qualified wages (or any amount capitalizable to basis) or for payroll taxes associated with such qualified wages. For example, assume a calendar year employer pays \$2,500 of qualified wages for the second quarter of 2020. If the employer claimed no ERTC, the employer would be able to deduct \$2,500 of wage expense (assuming such wages are not subject to capitalization) and \$155 of OASDI tax liability, for a total income tax deduction of \$2,655 for the quarter with respect to those wages. If the employer claims an ERTC of \$1,250 for those wages, the ERTC would offset \$155 of OASDI tax and \$1,095 of wage expense, leaving \$1,405 of qualified wages as deductible for income tax purposes.

Continuing the example above, assume that the employer delays the deposit of its \$155 of OASDI tax liability until December 31, 2021, pursuant to section 2302 of the CARES Act, and thus does not have a current income tax deduction for such OASDI tax.²⁵⁰ If the employer claims an ERTC of \$1,250, the ERTC would offset \$1,250 of wage expense, leaving \$1,250 of qualified wages as deductible for income tax purposes.

An employer may elect, at such time and in such manner as provided by the Secretary (or the Secretary's delegate), to have the credit not apply for a calendar quarter. Further, the credit is not available to the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any of those entities. Employers in the U.S. territories may claim the credit by filing their quarterly Federal employment tax returns.

The credit is not available for wages paid to any employee for any period with respect to any employer if such employer is allowed a credit under section 51 (*i.e.*, the work opportunity tax credit) with respect to such employee for such period. Furthermore, any wages taken into account in determining the credit shall not be taken into account for purposes of determining the credit allowed under section 45S (*i.e.*, the employer credit for paid family and medical leave).

²⁵⁰ In general, an employer's payroll tax liability is deductible when paid by the employer to the governmental authority. See sec. 461 and Treas. Reg. secs. 1.461-1 and 1.461-4(g). However, an accrual method employer who has adopted the recurring item exception method of accounting for its payroll taxes may generally deduct such taxes for which it has a fixed and determinable liability by the end of its taxable year if it pays the taxes by the earlier of the date the it files a timely income tax return (including extensions) for such taxable year or the 15th day of the ninth calendar month following the close of such taxable year (e.g., by September 15, 2021, for the 2020 calendar taxable year). See sec. 461(h), Treas. Reg. sec. 1.461-5, and Rev. Proc. 2008-25, 2008-1 C.B. 686. Thus, if the 2020 payroll taxes are not paid until December 31, 2021, they will not be deductible in 2020 by a calendar year employer, regardless of whether the employer uses the cash or accrual method of accounting.

Any credit allowed is treated as a credit described in section 3511(d)(2) (relating to third party payors).

The Secretary (or the Secretary's delegate) is directed to waive any penalty under section 6656 for failure to make a deposit of applicable employment taxes if the Secretary (or the Secretary's delegate) determines that such failure was due to the reasonable anticipation of the credit allowed.

The Secretary (or the Secretary's delegate) is required to provide such regulations or other guidance as may be necessary to carry out the purposes of the credit, including regulations or other guidance: (1) to allow the advance payment of the credit based on such information as the Secretary (or the Secretary's delegate) may require;²⁵¹ (2) to provide for the reconciliation of such advance payment with the amount advanced at the time of filing the return of tax for the applicable calendar quarter or taxable year; (3) to provide for recapture of the credit if it is allowed to a taxpayer which receives a small business interruption loan; (4) with respect to the application of the credit to third party payors (including professional employer organizations, certified professional employer organizations, or agents under section 3504), including regulations or guidance allowing such payors to submit documentation necessary to substantiate the eligible employer status of employers that use such payors; and (5) for application of the reduced gross receipts test to any employer which was not carrying on a trade or business for all or part of the same calendar quarter in the prior year.

Modifications in the Consolidated Appropriations Act, 2021

Sections 206, 207, and 303 of Division EE of the CAA modify the employee retention credit that was included in the CARES Act in the following ways.

Modifications that are effective as if included in the CARES Act

Section 206 of Division EE of the CAA clarifies that, in the case of an organization which is described in section 501(c) of the Code, any reference to gross receipts in the CARES

²⁵¹ For 2020, the IRS provided Form 7200, Advance Payment of Employer Credits Due to COVID-19, to allow taxpayers to request advance payment of the credit. The instructions to Form 7200 explain that:

Eligible employers who pay . . . qualified wages eligible for the employee retention credit should retain an amount of the employment taxes equal to the amount of . . . their employee retention credit, rather than depositing these amounts with the IRS. The employment taxes that are available for the credit[] include withheld federal income tax, the employee share of social security and HI taxes, and the employer share of social security and HI taxes with respect to all employees. If there aren't sufficient employment taxes to cover the cost of . . . the employee retention credit, employers can file Form 7200 to request an advance payment from the IRS. Don't reduce your deposits and request advance credit payments for the same expected credit. You will need to reconcile your advance credit payments and reduced deposits on your employment tax return.

See Instructions to IRS Form 7200, revised March 2020, available at <https://www.irs.gov/instructions/i7200>.

Act employee retention credit (as modified by the Act) shall be treated as a reference to gross receipts within the meaning of section 6033 of the Code.

Section 206 of Division EE of the CAA also clarifies that health plan expenses paid to provide and maintain a group health plan²⁵² are treated as wages that are eligible for the credit, assuming other requirements are met. The amount of such expenses per employee and per period shall be the amount properly allocable to such employee and such period under rules prescribed by the Secretary. Except as otherwise provided by the Secretary, an allocation of such expenses is proper if made on the basis of being pro rata among periods of coverage.

Section 206 of Division EE of the CAA alters the interaction of the credit and the Paycheck Protection Program. First, it removes the rule in section 2301(j) of the CARES Act that provided that an employer that received a Paycheck Protection Program (“PPP”) loan²⁵³ was ineligible for the credit, as well as the instruction to the Secretary in section 2301(l)(3) of the CARES Act to provide for recapture of the credit in the event it was allowed to a taxpayer who received a PPP loan. As a result, taxpayers receiving a PPP loan may be eligible for the credit. Section 1106 of the CARES Act²⁵⁴ is amended to provide that the definition of payroll costs that may give rise to loan forgiveness described in section 1106(b) of the CARES Act²⁵⁵ shall not include qualified wages taken into account in determining the credit. An employer may elect not to take into account any amount of the employer’s qualified wages for purposes of calculating the credit. However, such an election does not prevent payroll costs paid during the covered period from being treated as qualified wages of the eligible employer to the extent that a PPP loan is not forgiven by reason of a decision by the lender under section 1106(g) of the CARES Act²⁵⁶ to deny forgiveness.

Finally, section 206 of Division EE of the CAA requires the Secretary to issue such forms, instructions, regulations, and guidance as are necessary to prevent the avoidance of the purposes of the limitations on the credit, including through the leaseback of employees.

The effective date of section 206 of Division EE of the CAA includes a special rule permitting any employer who has filed a return of tax with respect to applicable employment taxes before the date of enactment of the Act to elect to treat any applicable amount as an amount paid in the calendar quarter which includes the date of enactment of the Act (*i.e.*, the 4th quarter of calendar year 2020). An applicable amount is any amount of either group health plan expenses treated as wages by subsection (b) of section 206 of Division EE of the CAA or wages

²⁵² As defined in section 5000(b)(1) of the Code.

²⁵³ Referred to in the statute as a “small business interruption loan” and defined as a covered loan under paragraph (36) of section 7(a) of the Small Business Act (15 U.S.C. 636(a), as added by section 1102 of the CARES Act).

²⁵⁴ Section 304(b)(1) of Title III of Division N of the Act redesignates section 1106 of the CARES Act as section 7A of the Small Business Act (15 U.S.C. § 631 et seq.).

²⁵⁵ Redesignated by the CAA as section 7A(b) of the Small Business Act.

²⁵⁶ Redesignated by the CAA as section 7A(g) of the Small Business Act.

permitted to be treated as qualified wages as a result of subsection (c)(2) of such section (addressing coordination between the Paycheck Protection Program and the credit), provided such amount was paid in a calendar quarter beginning after December 31, 2019, and before October 1, 2020, and was not taken into account by the taxpayer in calculating the credit for such calendar quarter.

Modifications that are effective for calendar quarters beginning after December 31, 2020

Section 207 of Division EE of the CAA extends the credit to apply to wages paid before July 1, 2021, extending by two calendar quarters the end-date provided by section 2301(m) of the CARES Act.

Section 207 of Division EE of the CAA makes certain changes to the limitations on the credit:

First, the percentage of qualified wages used to calculate the credit is increased from 50 percent of such wages to 70 percent of such wages.

Second, the amount of qualified wages per employee that may be taken into account in calculating the credit is increased from \$10,000 for all calendar quarters to \$10,000 per calendar quarter.

Third, an employer may qualify as an eligible employer under the reduced gross receipts test with respect to a calendar quarter for which the gross receipts of the employer are less than 80 percent of the gross receipts of the same employer for the same calendar quarter in 2019. For employers not in existence at the beginning of the relevant calendar quarter in 2019, this rule is applied by reference to the same calendar quarter in 2020 rather than 2019. Additionally, employers may elect to compare the gross receipts of the immediately preceding calendar quarter to the gross receipts for the corresponding calendar quarter in 2019, rather than using the quarter for which the credit is claimed. For employers not in existence in 2019, the election permits the employer to compare the gross receipts of the immediately preceding calendar quarter to the corresponding calendar quarter in 2020.

Fourth, with regard to the definition of qualified wages, the average number of full-time and full-time-equivalent employees the eligible employer may have had during 2019 to claim credit for any wages paid to an employee — rather than merely wages with respect to which the employee is not providing services — is increased from 100 or fewer to 500 or fewer.

Finally, the rule that qualified wages paid to an employee by an eligible employer that had more than 500 full-time employees in 2019 cannot exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately preceding the period in which the eligible employer met either the governmental order test or the reduced gross receipts test is eliminated.

The rule prohibiting certain government employers from claiming the credit is modified. First, any organization described in section 501(c)(1) of the Code and exempt from tax under section 501(a) of the Code is excluded from the rule. Second, any entity that is a college or university and any entity the principal purpose or function of which is providing medical or

hospital care is excluded from the rule. As a result, such organizations and entities are not prevented from claiming the credit by reason of the general prohibition against certain government employers claiming the credit. With respect to any organization or entity meeting either exception, wages as defined in section 3121(a) of the Code shall be determined for purposes of the credit without regard to paragraphs (5) and (6) (relating to certain services performed in the employ of the United States or an instrumentality of the United States), (7) (relating to certain services performed in the employ of a State, any political subdivision thereof, or any instrumentality of one or more of the foregoing which is wholly owned thereby), (10) (relating to certain services performed in connection with a school, college, or university), and (13) (relating to certain services performed as a student nurse) of section 3121(b).

Section 2301(h) of the CARES Act is revised to provide that any wages taken into account in determining the credit shall not be taken into account as wages for purposes of sections 41 (providing a credit for increasing research activities), 45A (the Indian employment credit), 45P (providing an employer wage credit for employees who are active duty members of the uniformed services), 45S (providing an employer credit for paid family and medical leave), 51 (the work opportunity credit), and 1396 (the empowerment zone employment credit).

Under rules to be provided by the Secretary, small employers (*i.e.*, those for whom the average number of full-time and full-time-equivalent employees during 2019 was not greater than 500) are permitted to elect to receive an advance payment of the credit for any quarter in an amount not to exceed 70 percent of the average quarterly wages paid by the employer in calendar year 2019. An employer who employs seasonal workers²⁵⁷ may elect a limitation equal to 70 percent of the wages for the calendar quarter in 2019 that corresponds to the calendar quarter to which the election relates, rather than 70 percent of average quarterly wages for 2019. For employers not in existence in 2019, the limitations under both the general rule and the election are calculated using 2020 numbers rather than 2020 numbers. The amount of the credit which would be allowed but for receipt of such an advance payment is reduced by the amount of the advance payment.²⁵⁸ If the advance payments to a taxpayer for a calendar quarter exceed the credit allowed but for receipt of the advance payment, the tax imposed by chapters 21 (FICA) or 22 (RRTA) of the Code (whichever is applicable) are increased by the amount of the excess.

The grant of authority in section 2301(l) of the CARES Act is modified to require that any forms, instructions, regulations, or guidance issued with respect to application of the credit to third party payors (including professional employer organizations, certified professional employer organizations, or agents under section 3504 of the Code) require the customer to be responsible for the accounting of the credit and for any liability for improperly claimed credits. Such forms, etc., shall require the third party payor to accurately report the credit based on the information provided by the customer.

The Secretary is required to conduct a public awareness campaign, in coordination with the Administrator of the Small Business Administration, to provide information regarding the

²⁵⁷ As defined in section 45R(d)(5)(B) of the Code.

²⁵⁸ Any failure to so reduce the credit is treated as arising out of a mathematical or clerical error and any excess tax due as a result is assessed according to section 6213(b) of the Code.

availability of the credit. As part of the outreach, the Secretary is required to provide notice about the credit to all employers who reported 500 or fewer employees on their most recently filed employment tax return, and, within 30 days of the date of enactment of the Act, provide educational materials about the credit to all employers.

An election not to take into account any amount of the employer's qualified wages for purposes of calculating the credit does not prevent payroll costs paid during the covered period from being treated as qualified wages of the eligible employer to the extent that a Paycheck Protection Program second draw loan described in 15 U.S.C. section 636(a)(37) is not forgiven by reason of the application of paragraph (37)(J) of such section.

Finally, section 303 of Division EE of the CAA provides that the credit is reduced by any credit allowed for wages paid by certain tax-exempt organizations affected by qualified disasters in 2020.²⁵⁹

Description of Proposal

The proposal extends the credit by two calendar quarters to apply to wages paid before January 1, 2022.

The proposal replaces the credit against the employer's share of OASDI tax and the equivalent amount of RRTA tax with a credit against the employer's share of HI tax and the equivalent amount of RRTA tax.²⁶⁰

As revised by the proposal, the credit allowed may not exceed the applicable employment taxes imposed on the eligible employer for that calendar quarter on the wages paid with respect to all of the employer's employees, reduced by any credits allowed for paid sick or family leave under sections 7001 and 7003 of the FFCRA.²⁶¹ However, if for any calendar quarter the

²⁵⁹ Section 303 of Division EE of the CAA, 2021 provides an employee retention credit for certain employers affected by qualified disasters in 2020, which includes a payroll tax credit for certain tax-exempt organizations (see section 303(d) of such Act).

²⁶⁰ As a result, the credit is not reduced by any credits allowed for the employment of qualified veterans, for research expenditures of a qualified small business, or for wages paid by certain tax-exempt organizations affected by qualified disasters in 2020. See the discussion of changes made to the credits for paid sick or family leave under sections 7001 and 7003 of the FFCRA elsewhere in this document. Also, the proposal does not include express language that "holds harmless" the Federal Hospital Insurance Trust Fund from any effects of the proposal. Under current law, amounts appropriated and transferred to the trust fund include amounts equivalent to 100% of the taxes imposed by section 3111(b) with respect to applicable wages reported by the Secretary, determined by applying the rate to the reported wages. Sec. 1807 of the Social Security Act, 42 U.S.C. sec. 1395i. Because the proposal does not affect either the rate under section 3111(b) or applicable wages, but only provides a credit against the amount of tax, the proposal does not affect the trust fund, and no hold harmless language is needed.

²⁶¹ Under section 9647 of the bill, section 7001 and 7003 of the FFCRA are amended to be credits against the employer's share of HI tax and the equivalent amount of RRTA tax, for calendar quarters beginning after March 31, 2021. See the detailed discussion of "Credits Allowed Against Employer Hospital Insurance Tax" elsewhere in this document.

amount of the credit exceeds the applicable employment taxes imposed on the employer, reduced as described in the prior sentence, such excess is treated as a refundable overpayment.

Effective Date

The proposal is effective for calendar quarters beginning after June 30, 2021.

PART VII—PREMIUM ASSISTANCE CREDIT

A. Temporary Modifications to the Premium Assistance Credit

Present Law

In general

A refundable tax credit (the “premium assistance credit”) is provided for eligible individuals and families to subsidize the purchase of “qualified health plans,”²⁶² health insurance plans offered through an American Health Benefit Exchange (“Exchange”) created by the Patient Protection and Affordable Care Act (“PPACA”).²⁶³ In general, the Treasury Department makes advance payments with respect to the premium assistance credit during the year directly to the insurer, as discussed below.²⁶⁴ However, eligible individuals may choose to pay their total health insurance premiums without advance payments and to claim the credit for the taxable year on a Federal income tax return.

The premium assistance credit is generally available for individuals (single or joint filers) with household incomes between 100 percent and 400 percent of the Federal poverty level (“FPL”) for the applicable family size.²⁶⁵ Household income is defined as the sum of (1) the individual’s modified AGI, plus (2) the aggregate modified AGI of all other individuals taken into account in determining the individual’s family size (but only if the other individuals are required to file tax returns for the taxable year).²⁶⁶ Modified AGI is defined as AGI increased by (1) any amount excluded from gross income for citizens or residents living abroad,²⁶⁷ (2) any tax-exempt interest received or accrued during the tax year, and (3) any portion of the individual’s Social Security benefits not included in gross income.²⁶⁸ To be eligible for the

²⁶² Sec. 36B. Qualified health plans generally must meet certain requirements. Secs. 1301 and 1302 of the PPACA, 42 U.S.C. secs. 18021 and 18022.

²⁶³ Pub. L. No. 111-148, March 23, 2010. The PPACA was modified by the Health Care and Education Reconciliation Act of 2010 (“HCERA”), Pub. L. No. 111-152, Title I, sec. 1001, March 30, 2010. PPACA and HCERA are referred to collectively as the Affordable Care Act (“ACA”).

²⁶⁴ Sec. 1412 of the PPACA, 42 U.S.C. sec. 18082.

²⁶⁵ Sec. 36B(c)(1). Federal poverty level refers to the most recently published poverty guidelines determined by the Secretary of Health and Human Services (“HHS”). Levels for 2021 and previous years are available at <https://aspe.hhs.gov/prior-hhs-poverty-guidelines-and-federal-register-references>.

Under sec. 36B(c)(1)(B), a taxpayer with household income less than 100 percent of FPL who is an alien lawfully present but is ineligible for Medicaid under title XIX of the Social Security Act by reason of such alien status may be treated as an applicable taxpayer with a household income equal to 100 percent of FPL.

²⁶⁶ Sec. 36B(d)(2).

²⁶⁷ Sec. 911.

²⁶⁸ Under section 86, only a portion of an individual’s Social Security benefits is included in gross income.

premium assistance credit, individuals who are married must file a joint return.²⁶⁹ Individuals who are listed as dependents on a return are not eligible for the premium assistance credit.

An individual who is eligible for minimum essential coverage from a source other than the individual insurance market generally is not eligible for the premium assistance credit.²⁷⁰ However, an individual who is offered minimum essential coverage under an employer-sponsored health plan may be eligible for the premium assistance credit if (1) the coverage is either unaffordable or does not provide minimum value, and (2) the individual declines the employer-offered coverage.²⁷¹ Thus, an individual who enrolls in an employer-sponsored health plan generally is ineligible for the premium assistance credit even if the coverage is considered unaffordable or does not provide minimum value. Coverage is considered unaffordable if an employee's share of the premium for self-only coverage under the plan exceeds 9.83 percent (for 2021)²⁷² of the employee's household income.²⁷³ Coverage is considered to not provide minimum value if the plan's share of total allowed costs of plan benefits is less than 60 percent of such costs.

Amount of credit

The premium assistance credit amount is generally the lower of (1) the premium for the qualified health plan in which the individual or family enrolls, and (2) the premium for the second lowest cost silver plan in the rating area where the individual resides,²⁷⁴ reduced by the

²⁶⁹ Sec. 36B(c)(1)(C).

²⁷⁰ Sec. 36B(c)(2). Minimum essential coverage is defined in section 5000A(f).

²⁷¹ Sec. 36B(c)(2)(C).

²⁷² Rev. Proc. 2020-36, 2020-32 I.R.B. 244.

²⁷³ Employees and their family members who are provided a qualified small employer health reimbursement arrangement ("QSEHRA") that constitutes affordable coverage are not eligible for the premium assistance credit. Sec. 36B(c)(4)(C). The affordability determination for QSEHRAs is similar to the affordability determination for an employer-sponsored health plan. Specifically, a QSEHRA is treated as constituting affordable coverage for a month if an employee's share of the premium for self-only coverage under the second lowest cost silver plan offered in the relevant individual health insurance market does not exceed 9.83 percent (for 2021) of the employee's household income. A QSEHRA is defined in section 9831(d)(2).

²⁷⁴ A "silver plan" refers to the level of coverage provided by the health plan. PPACA sec. 1302(d), 42 U.S.C. sec. 18022. Most health plans sold through an Exchange are required to meet actuarial value ("AV") standards, among other requirements. AV is a summary measure of a plan's generosity, expressed as a percentage of medical expenses estimated to be paid by the insurer for a standard population and set of allowed charges. Silver-level plans are designed to provide benefits that are actuarially equivalent to 70 percent of the full AV of the benefits provided under the plan. The premium assistance credit looks to the second lowest cost plan of all of the silver plans available in the relevant rating area.

An individual's "rating area" refers to the geographical unit within the State where the individual resides. Insurers may vary individual market premiums based on rating areas, among other factors. See PPACA sec. 1201, 42 U.S.C. 300gg.

individual’s or family’s share of premiums.²⁷⁵ As shown in Table 1 below, an individual’s or a family’s share of premiums is a certain percentage of household income. For 2021, the share of premiums is 2.07 percent of household income up to 133 percent of FPL and is determined on a sliding scale in a linear manner up to 9.83 percent as household income rises from 133 percent of FPL to 400 percent of FPL.

Table 1.–Household’s Share of Premiums (for 2021)²⁷⁶

Household income (expressed as a percent of FPL)	Initial percentage of household income*	Final percentage of household income*
Less than 133%	2.07	2.07
133% up to 150%	3.10	4.14
150% up to 200%	4.14	6.52
200% up to 250%	6.52	8.33
250% up to 300%	8.33	9.83
300% up to and including 400%	9.83	9.83

* The initial percentage of household income corresponds to the bottom of the corresponding FPL range, and the final percentage of household income corresponds to the top of the corresponding FPL range.

Advance payments of the premium assistance credit

As part of the process of enrollment in a qualified health plan through an Exchange, an individual may apply and be approved for advance payments with respect to a premium assistance credit (“advance payments”).²⁷⁷ The individual must provide information on income, family size, changes in marital or family status or income, and citizenship or lawful presence

²⁷⁵ Sec. 36B(b). The amount of the premium assistance credit is determined on a monthly basis, and the amount of the credit for a year is the sum of the monthly amounts.

²⁷⁶ Rev. Proc. 2020-36, 2020-32 I.R.B. 244. The percentages are indexed to the excess of premium growth over income growth for the preceding calendar year. After 2018, if the aggregate amount of premium assistance credits (and cost-sharing reductions under section 1402 of PPACA) exceeds 0.504 percent of the gross domestic product for that year, the percentage of household income is also adjusted to reflect the excess (if any) of premium growth over the rate of growth in the Consumer Price Index for the preceding calendar year. Such an adjustment was not required for 2021.

²⁷⁷ Secs. 1411 and 1412 of PPACA, 42 U.S.C. secs. 18081 and 18082. Under section 1402 of PPACA, 42 U.S.C. sec. 18071, certain individuals eligible for advance premium assistance payments also are eligible for a reduction in their share of medical costs, such as deductibles and copays, under the plan, referred to as reduced cost-sharing. Eligibility for reduced cost-sharing is also determined as part of the Exchange enrollment process. HHS is responsible for rules relating to Exchanges and the eligibility determination process.

status.²⁷⁸ Eligibility for advance payments is generally based on the individual's income for the taxable year ending two years prior to the enrollment period. The Exchange process is administered by HHS and includes a system through which information provided by the individual is verified using information from the IRS and certain other sources.²⁷⁹ If an individual is approved for advance payments, the Secretary pays the advance amounts on a monthly basis directly to the issuer of the health plan in which the individual is enrolled. The individual then pays to the issuer of the plan the difference between the advance payment amount and the total premium charged for the plan.

An individual on whose behalf advance payments of the premium assistance credit for a taxable year are made is required to file an income tax return to reconcile the advance payments with the credit that the individual is allowed for the taxable year.²⁸⁰

If the advance payments of the premium assistance credit exceed the amount of credit that the individual is allowed, the excess ("excess advance payments") is treated as an additional tax liability on the individual's income tax return for the taxable year (is "recaptured"), subject to a limit on the amount of additional liability in some cases. For an individual with household income below 400 percent of FPL, recapture for a taxable year is limited to a specific dollar amount (the "applicable dollar amount") as shown in Table 2 below. One-half of the applicable dollar amount shown in Table 2 applies to an unmarried individual who is not a surviving spouse or filing as a head of household.

²⁷⁸ Under section 1312(f)(3) of PPACA, 42 U.S.C. sec. 18032(f)(3), an individual may not enroll in a qualified health plan through an Exchange if the individual is not a citizen or national of United States or an alien lawfully present in the United States. Thus, such an individual is not eligible for the premium assistance credit.

²⁷⁹ Under section 6103, returns and return information are confidential and may not be disclosed, except as authorized by the Code, by IRS employees, other Federal employees, State employees, and certain others having access to such information. Under section 6103(l)(21), upon written request of the Secretary of HHS, the IRS is permitted to disclose certain return information for use in determining an individual's eligibility for advance premium assistance payments, reduced cost-sharing, or certain other State health subsidy programs, including a State Medicaid program under title XIX of the Social Security Act, 42 U.S.C. secs. 1396w-1 through 1396w-5, a State's Children's Health Insurance Program under title XXI of the Social Security Act, 42 U.S.C. secs. 1397aa through 1397mm, and a Basic Health Program under section 1331 of PPACA, 42 U.S.C. sec. 18051.

²⁸⁰ Treas. Reg. sec. 1.6011-8. Under section 6055, health insurance issuers are required to report to the IRS and to the individual the months during a year for which the individual was covered by minimum essential coverage issued by the insurer. In Notices 2019-63 and 2020-76, however, the IRS announced that for 2019 and 2020 it will not assess penalties for the failure to provide the required statement to individuals if certain conditions are met, following the reduction of the individual shared responsibility payment in section 5000A to \$0. 2019-51 I.R.B. 1390; 2020-47 I.R.B. 1058.

In addition, under section 36B(f)(3), an Exchange is required to report to the IRS and to the individual the months during a year for which the individual was covered by a qualified health plan purchased through the Exchange; the level of coverage; the name, address, and TIN of the primary insured and each individual covered by the policy; the total premiums paid by the individual; and, if applicable, advance premium assistance payments made on behalf of the individual.

Table 2.—Recapture Limits (for 2021)²⁸¹

Household income (expressed as a percent of FPL)	Applicable dollar amount
Less than 200%	\$650
At least 200% but less than 300%	\$1,600
At least 300% but less than 400%	\$2,700

If the advance payments of the premium assistance credit for a taxable year are less than the amount of the credit that the individual is allowed, the additional credit amount is allowed when the individual files an income tax return for the year.

Enrollment in a qualified health plan

Generally, an individual may enroll in a qualified health plan through an Exchange during an annual open enrollment period.²⁸² The 2021 open enrollment period in most States ended December 15, 2020. An Exchange must provide for special enrollment periods during which an individual may enroll in a qualified health plan or change enrollment in a qualified health plan if the individual experiences certain life events, including losing health coverage, getting married, or having a baby.²⁸³ On January 28, 2021, the President issued an Executive Order ordering the Secretary of HHS to consider establishing a special enrollment period for the Federally Facilitated Marketplace in light of the exceptional circumstances caused by the ongoing COVID-19 pandemic and the economic downturn.²⁸⁴ In accordance with the Executive Order, HHS determined that it will provide a special enrollment period for the Federal Facilitated Marketplace from February 15, 2021 through May 15, 2021.²⁸⁵ HHS strongly encouraged States operating their own marketplace platforms to establish similar enrollment opportunities.

²⁸¹ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016. The applicable dollar amounts are indexed to reflect cost-of-living increases, with the amount of any increase rounded down to the next lowest multiple of \$50.

²⁸² PPACA sec. 1311, 42 U.S.C. 13031.

²⁸³ 45 CFR 155.420.

²⁸⁴ Joseph R. Biden, “Executive Order on Strengthening Medicaid and the Affordable Care Act,” January 28, 2021, available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/28/executive-order-on-strengthening-medicare-and-the-affordable-care-act/>. Pursuant to 45 C.F.R. 155.420(d)(9), an Exchange may allow a special enrollment period in the event of exceptional circumstances as determined by the Exchange in accordance with HHS guidelines.

²⁸⁵ Centers for Medicare & Medicaid Services, “Fact Sheet: 2021 Special Enrollment Period in Response to the COVID-19 Emergency,” January 28, 2021, available at <https://www.cms.gov/newsroom/fact-sheets/2021-special-enrollment-period-response-covid-19-emergency>.

Unemployment Compensation

Unemployment compensation benefits are includible in gross income.²⁸⁶ Unemployment compensation is defined as any amount received under a law of the United States or of a State which is in the nature of unemployment compensation.²⁸⁷ The CARES Act temporarily expanded states' ability to provide unemployment insurance for many workers impacted by the COVID-19 pandemic, including for workers who are not ordinarily eligible for unemployment benefits.²⁸⁸ The CAA generally extended and reauthorized certain provisions of the CARES Act unemployment insurance expansion.²⁸⁹

Description of Proposal

Improving affordability by expanding premium assistance for consumers

For taxable years beginning in 2021 and 2022, the proposal reduces or eliminates an individual's or family's share of premiums used in determining the amount of the premium assistance credit. The proposal also makes the premium assistance credit available to taxpayers with incomes above the present law limitation of 400 percent of FPL for the applicable family size.

Table 3 below shows an individual's or family's modified share of premiums applicable for 2021 and 2022 under the proposal. The share of premiums is a certain percentage of household income, ranging from 0.0 percent of household income (up to 150 percent of FPL) up to 8.5 percent of household income, determined on a sliding scale in a linear manner.

**Table 3.—Household's Share of Premiums
(for 2021 and 2022)**

Household income (expressed as a percent of FPL)	Initial percentage of household income	Final percentage of household income
Less than 150%	0.0	0.0
150% up to 200%	0.0	2.0
200% up to 250%	2.0	4.0
250% up to 300%	4.0	6.0

²⁸⁶ Sec. 85.

²⁸⁷ Sec. 85(b); see also Treas. Reg. sec. 1.85-1(b)(1).

²⁸⁸ Pub. L. No. 116-136, Div. A, Title II, subtitle A.

²⁸⁹ Pub. L. No. 116-260, Div. N, Title II, subtitle A.

Household income (expressed as a percent of FPL)	Initial percentage of household income	Final percentage of household income
300% up to 400%	6.0	8.5
400% and higher	8.5	8.5

Taxpayers may be able to take advantage of the COVID-19 related special enrollment period to receive the benefit of this temporary expansion.

Temporary modification of limitations on reconciliation of tax credits

For a taxable year beginning in 2020, the proposal removes the requirement that excess advance payments are treated as an additional tax liability on the individual’s income tax return for the taxable year. Accordingly, under the proposal no excess advance payment is subject to recapture. The proposal applies to taxpayers who file a 2020 income tax return and reconcile any advance payment of the credit.²⁹⁰

Application of premium assistance credit in case of individuals receiving unemployment compensation during 2021

The proposal provides a special rule for the premium assistance credit in the case of a taxpayer who has received, or has been approved to receive, unemployment compensation for any week during calendar year 2021.²⁹¹ Under the rule, for a taxable year beginning in 2021, (i) such a taxpayer is treated as an applicable taxpayer, and (ii) the taxpayer’s household income is not taken into account to the extent it exceeds 133 percent of FPL for a family of the size involved. Accordingly, under the proposal, a taxpayer receiving unemployment compensation during 2021 and whose household income exceeds 133 percent of FPL may receive a larger premium assistance credit and may be subject to lower recapture than under present law. In addition, a taxpayer receiving unemployment compensation during 2021 whose household income is less than 100 percent of FPL may be allowed a premium assistance credit.

This special rule does not affect the requirement that married couples must file a joint return to claim the premium assistance credit. The special rule also does not apply to determinations of household income for purposes of determining the affordability of employer-sponsored health plans and QSEHRAs.

The taxpayer must attest to receipt of or approval for unemployment compensation to receive the benefit of the special rule. The Secretary may prescribe documentation requirements to verify the taxpayer’s receipt of or approval for unemployment compensation. These

²⁹⁰ All taxpayers who receive the benefit of advance payments of the premium assistance credit are required to file an income tax return for the taxable year and reconcile the advance credit payments. Treas. Reg. sec. 1.6011-8. Advance payments of the premium assistance credit are reported on Form 8962, *Premium Tax Credit*, line 29, and on Form 1040, Schedule 2, *Additional Taxes*, line 2.

²⁹¹ Unemployment compensation is as defined in section 85(b).

requirements could include information available to the Secretary from third-party information reporting.²⁹²

Taxpayers may be able to take advantage of the COVID-19 related special enrollment period to receive the benefit of this special rule.

Effective Date

The proposals to temporarily expand the premium assistance credit and to provide a special rule for certain unemployed individuals apply to taxable years beginning after December 31, 2020.

The proposal to temporarily modify the recapture limitations applies to taxable years beginning after December 31, 2019.

²⁹² See sec. 6050B (returns relating to unemployment compensation).

PART VIII—MISCELLANEOUS PROVISIONS

A. Repeal of Worldwide Allocation of Interest Election

Present Law

For purposes of computing the section 904 foreign tax credit limitation, a taxpayer must determine the amount of its taxable income from foreign sources. As part of this determination, the taxpayer must allocate and apportion deductions between U.S.-source gross income and foreign-source gross income in each limitation category.

The current rules generally treat interest expense as being properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring a specific obligation on which interest is paid. For purposes of allocating and apportioning interest expense, all members of an affiliated group of corporations generally are treated as a single corporation (the so-called “one-taxpayer rule”) and the allocation and apportionment of such expense must be made on the basis of assets, rather than gross income.²⁹³ An affiliated group in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns.²⁹⁴ As with the rules for filing a consolidated return, the definition of affiliated group for interest expense allocation and apportionment purposes generally also excludes foreign corporations.²⁹⁵ Thus, while debt generally is considered fungible among the assets of a group of domestic affiliated corporations, the same rules do not apply between the domestic and foreign members of a group.

For the first taxable year beginning after December 31, 2020,²⁹⁶ section 864(f) provides that the common parent of a U.S. affiliated group may elect to allocate and apportion the interest

²⁹³ Sec. 864(e)(1), (e)(2).

²⁹⁴ Sec. 864(e)(5). For consolidation purposes, the term affiliated group is one or more chains of includible corporations connected through stock ownership with a common parent corporation that is an includible corporation, but only if: (1) the common parent owns directly stock possessing at least 80 percent of the total voting power and at least 80 percent of the total value of the stock of at least one other includible corporation; and (2) stock meeting the same voting power and value standards with respect to each includible corporation (excluding the common parent) is directly owned by one or more other includible corporations. Generally, an includible corporation is any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation. Sec. 1504.

²⁹⁵ Secs. 864(e)(5), 1504(b)(3). An exception to this general rule excluding foreign corporations is that the affiliated group for interest allocation purposes includes a foreign corporation if more than 50 percent of its gross income for the taxable year is effectively connected with the conduct of a U.S. trade or business and at least 80 percent of the vote or value of all outstanding stock of the foreign corporation is owned directly or indirectly by members of the affiliated group (determined with regard to this sentence). Sec. 864(e)(5)(A).

²⁹⁶ Section 864(f), added to the Code by section 401 of the American Jobs Creation Act, Pub. L. No. 108-357, in 2004, with delayed effective dates, most recently delayed until taxable years beginning in 2021. See Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, sec. 551(a).

expense of each member of its worldwide affiliated group²⁹⁷ as if all domestic and foreign affiliates are a single corporation. The election is a one-time election, due with the filing of the first return beginning after December 31, 2020, in which a worldwide affiliated group exists and has at least one foreign corporation. It is irrevocable absent consent of the IRS. A result of this rule is that interest expense of foreign members of the worldwide affiliated group is taken into account in determining whether a portion of the interest expense of the domestic members of the group must be allocated to foreign-source income. An allocation to foreign-source income generally is required only if, in broad terms, the domestic members of the group are more highly leveraged than is the entire worldwide group.

Description of Proposal

The proposal repeals the provision permitting taxpayers to elect to allocate and apportion interest expense on a worldwide basis.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2020.

²⁹⁷ As defined in subsection 864(f)(1)(C), a worldwide affiliated group includes eligible members determined without regard to the limitations of section 1504(b)(2) (insurance companies subject to tax under section 801) and controlled foreign corporations if the members of the group in aggregate meet ownership requirements of section 1504(a)(2).

B. Tax Treatment of Targeted EIDL Advances and Tax Treatment of Restaurant Revitalization Grants

Present Law

Tax treatment relating to amounts excluded from income

Exclusions from income

Gross income means all income from whatever source derived.²⁹⁸ Specific exclusions from income apply to certain otherwise includable amounts and payments, however. For example, the forgiveness of a loan is generally treated as discharge of indebtedness income to the borrower,²⁹⁹ but limited exclusions apply to income from a discharge of indebtedness that occurs in a Title 11 case (generally, a bankruptcy case), or that occurs when the taxpayer is insolvent to the extent of the insolvency amount, or arises from the discharge of qualified farm indebtedness.³⁰⁰ Similarly, income exclusions apply to qualified disaster relief payments and qualified disaster mitigation payments.³⁰¹

Effect of income exclusion on deductions, tax attributes, and basis

In general.—Several provisions limit deductions, tax attributes, or basis increases associated with excluded income. These provisions maintain accurate income measurement by preventing the reduction of taxable income for costs associated with untaxed income.

Limitations on deductions.—One such rule, section 265, disallows deductions that are allocable to a class of income wholly exempt from income tax.³⁰² Similarly, a pro rata limitation on interest deductions applies in the case of a financial institution with tax-exempt interest income.³⁰³ An interest deduction limitation rule applies in the case of a life insurance contract, the death benefit under which is excludable from income by section 101(a).³⁰⁴

²⁹⁸ Sec. 61; *U.S. v. Kirby Lumber Co.*, 284 U.S. 1 (1931).

²⁹⁹ Sec. 61(11).

³⁰⁰ Sec. 108(a).

³⁰¹ Sec. 139.

³⁰² Sec. 265(a)(1). This rule applies with respect to exempt income other than interest; section 265 also disallows the deduction for interest expense on debt incurred or continued to purchase or carry obligations the interest income on which is wholly exempt from income tax (sec. 265(a)(2)), and disallows deductions otherwise allowable under section 212 for expenses for the production of interest income wholly exempt from income tax.

³⁰³ The limitation ratio is (1) the average adjusted bases of certain types of tax-exempt obligations, to (2) average adjusted bases for all assets of the taxpayer (sec. 265(b)).

³⁰⁴ Sec. 264(f). This pro rata interest deduction limitation permits no deduction for that portion of the taxpayer's interest expense determined by applying the ratio of (1) unborrowed policy cash values, to (2) the sum of

Reductions in tax attributes.—In the case of discharge of indebtedness income that is excluded from income,³⁰⁵ rules for reduction of tax attributes apply.³⁰⁶ The excluded amount is applied to reduce the tax attributes of the taxpayer in the order prescribed by statute: (1) net operating losses, (2) general business credit, (3) minimum tax credit, (4) capital loss carryovers, (5) basis of the taxpayer's property, (6) passive activity loss and credit carryovers, and (7) foreign tax credit carryovers.

Limitations on basis increases.—Limitations apply to otherwise allowable increases in the basis of property associated with excluded income. For example, in the case of qualified disaster mitigation payments that are excluded from income, no increase in the basis or adjusted basis of property is allowed for any amount so excluded.³⁰⁷

Circumstances in which limitations not imposed.—Limitations on deductions, tax attributes, or basis increases are not imposed in certain situations in which the policy of the exclusion may outweigh the income tax policy of accurate income measurement. For example, in the case of excludable parsonage and military housing allowances, no deduction is denied for mortgage interest or real property taxes on the taxpayer's home under the section 265 deduction limitation by reason of the receipt of the excludable amount.³⁰⁸ As another example, the pro rata interest deduction limitation for financial institutions with exempt income generally does not apply in the case of tax-exempt obligations issued in 2009 or 2010.³⁰⁹

Tax treatment of partnerships.—A partnership generally is not subject to Federal income tax, but rather, income and gain of the partnership are generally taxed to partners. Items of partnership income (including tax exempt income), gain, loss, deduction, and credit pass through to partners.³¹⁰ Although loss (including capital loss) and deductions of the partnership pass through to partners, a partner is allowed a loss or deduction only to the extent of the adjusted

all the taxpayer's average unborrowed policy cash values and average adjusted bases of all other assets (sec. 264(f)(1) and (2)).

³⁰⁵ Sec. 108.

³⁰⁶ Secs. 108(b) and 1017.

³⁰⁷ Sec. 139(g)(3). See also section 139(h) (denial of double benefit rule). As another example, the basis of property is reduced to the extent of contributions to capital of a corporation excludable from gross income under section 118 (see sec. 362).

³⁰⁸ Sec. 265(a)(6).

³⁰⁹ Sec. 265(b)(7). This rule is subject to the proviso that the amount of such tax-exempt obligations does not exceed two percent of the taxpayer's average adjusted bases of tax-exempt obligations to which the interest limitation does apply. The years 2009 and 2010 followed the financial crisis of 2008.

³¹⁰ Secs. 701 and 702.

basis of the partnership interest at the end of the partnership year in which the loss occurs or the deduction arises.³¹¹

Tax exempt or excluded income items of the partnership can affect the partner's basis in the partnership interest. Adjustments are made to the basis of a partner's interest to account for the partner's distributive share of partnership items.³¹² The basis in the partnership interest is increased by the partner's distributive share of partnership income, including income that is exempt from tax.³¹³ A partner's basis in the partnership interest generally is increased by an increase in the partner's share of partnership liabilities and is decreased by a decrease in the partner's share of liabilities.³¹⁴

Tax treatment of S corporations.—Income of an S corporation is taxed to the S corporation shareholders. Each S corporation shareholder's pro rata share of S corporation income (including tax exempt income), gain, loss, deduction and credit is passed through to the shareholder.³¹⁵ The basis of an S corporation shareholder's stock is adjusted to account for the shareholder's pro rata share of S corporation income (including tax exempt income³¹⁶), loss, deduction or credit. An S corporation shareholder's stock basis is not adjusted to take account of S corporation-level debt (unlike a partner's basis in its partnership interest).

Targeted EIDL advances that are not required to be repaid

The CARES Act³¹⁷ provides that an eligible entity that applies for a specified type of Small Business Act loan³¹⁸ may request an advance.³¹⁹ The advance generally may not exceed

³¹¹ Sec. 704(d). Other limitations may apply. See *e.g.*, secs. 465 and 469.

³¹² The basis of a partner's interest that is acquired by contribution to the partnership is generally the amount of money and the adjusted basis of property contributed (sec. 722) and is adjusted under section 705. Section 705 provides that the basis of the partnership interest is increased by the sum of the partner's distributive share of taxable income, income exempt from tax, and the excess of depletion deductions over the basis of the depletable property. The basis of the partnership interest is decreased by distributions from the partnership and by the sum of the partner's distributive share of losses, expenditures that are not deductible in computing taxable income and not properly chargeable to capital account, and certain depletion deductions.

³¹³ Sec. 705(a)(1)(B).

³¹⁴ Sec. 752. An increase in a partner's share of partnership liabilities is treated as a contribution to the partnership (sec. 752(a)), and a decrease in a partner's share of partnership liabilities is treated as a distribution from the partnership (sec. 752(b)).

³¹⁵ Secs. 1363(a) and 1366.

³¹⁶ Secs. 1367(a)(1)(A) and 1366(a)(1)(A).

³¹⁷ Pub. L. No. 116-136.

³¹⁸ Economic Injury Disaster Loan ("EIDL"). This is a loan under section 7(b)(2) of the Small Business Act, 15 U.S.C. 636(b)(2).

³¹⁹ CARES Act sec. 1110(e).

\$10,000. The applicant is not required to repay the advance, even if the loan for which the applicant applied is subsequently denied.³²⁰

The CAA³²¹ (amending the CARES Act) adds that an EIDL advance that is not repaid in whole or in part is not included in the income of the person that receives the advance, for Federal income tax purposes.³²² In the case of EIDL funding that is received relating to small business continuation, adaptation, and resiliency,³²³ the funding is not included in the income of the person that receives the funding.³²⁴

Further, no deduction is denied, no tax attribute is reduced, and no basis increase is denied, by reason of the exclusion from income. As a result, otherwise deductible costs remain deductible even if the costs are paid with the excluded income or are associated with the excluded amount. Similarly, because section 108 does not apply, no tax attribute is reduced by reason of the exclusion.³²⁵ Further, an otherwise allowable increase in the basis of property remains allowable even if the expenditure giving rise to the basis increase is paid with the excluded income or is associated with the excluded amount. For example, if a person engaged in a trade or business receives an EIDL advance or funding described in the provision and uses the proceeds to pay deductible wages of employees of the business, the section 162 deduction for the wages is not disallowed even though the advance or funding is excluded from the taxpayer's income.

If the person that receives the advance or funding is a partnership or S corporation, any amount excluded from income by reason of the provision is treated as tax exempt income for purposes of sections 705 (the determination of a partner's basis in the partnership interest) and 1366 (the passthrough of items to an S corporation shareholder). The provision also requires the Secretary of the Treasury (or the Secretary's delegate) to prescribe rules for determining a

³²⁰ CARES Act sec. 1110(e)(5).

³²¹ Pub. L. No. 116-260.

³²² Secs. 278(b) and (e)(1) of Division N of the CAA, effective for taxable years ending after the date of enactment of the CARES Act (March 27, 2020).

³²³ This funding is provided in section 331 of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act, which is in Division N of the CAA. The total amount of such funding that a covered entity may receive is \$10,000, and if a covered entity received an EIDL grant (advance) under section 1110(e) of the CARES Act, the amount of the grant under section 331 of Division N is the difference between \$10,000 and the amount of the previously received grant (Div. N, sec. 331(b)). A covered entity for this purpose is generally defined as an entity that is eligible for a specified type of Small Business Administration loan, applies for such a loan during the period January 31, 2020 and ending December 31, 2021, is located in a low-income community, has suffered an economic loss of greater than 30 percent, and employs no more than 300 employees (Div. N, sec. 331(a)(2)).

³²⁴ Sec. 278(b) of Division N of the CAA.

³²⁵ Because the exclusion from income is allowed under section 278(b) of Division N of the CAA, and not under section 108, the tax attribute reduction requirements that relate to the income exclusion under section 108 do not apply.

partner's distributive share of any amount treated as tax exempt income under the provision for purposes of the determination of a partner's basis in the partnership interest.

For example, assume that a business partnership has two partners (A and B). The partnership is engaged in a trade or business, receives an EIDL advance of \$10,000 that is not repaid, and uses the proceeds to pay deductible wages of employees of the business. The deduction for the wages is not disallowed even though the advance is excluded from the taxpayer's income. A's and B's aggregate basis in the partnership is increased by \$10,000. Treasury guidance will determine by how much each of A's and B's basis in the partnership, respectively, is increased.

Description of Proposal

Tax treatment relating to targeted EIDL advances

In connection with the appropriation of additional funds for targeted EIDL advances by another Committee, the proposal provides that for Federal income tax purposes the targeted EIDL advance is not included in the income of the person that receives the amount. No deduction is denied, no tax attribute is reduced, and no basis increase is denied, by reason of the exclusion from income. If the person that receives the advance is a partnership or S corporation, any amount excluded from income by reason of the proposal is treated as tax exempt income for purposes of the determination of the basis of a partner's interest in the partnership and the passthrough of items to an S corporation shareholder. The proposal requires the Secretary of the Treasury (or the Secretary's delegate) to prescribe rules for determining a partner's distributive share of any amount so treated as tax exempt income for purposes of determining the basis of a partner's interest in the partnership. Thus, the proposal gives Federal income tax treatment identical to such treatment for EIDL advances under the CAA.

Tax treatment relating to Restaurant Revitalization grants

In connection with the establishment of the Restaurant Revitalization Fund and the associated appropriation of funds by another Committee, the proposal provides that for Federal income tax purposes a Restaurant Revitalization grant is not included in the income of the person that receives the amount. No deduction is denied, no tax attribute is reduced, and no basis increase is denied, by reason of the exclusion from income. Except as otherwise provided by the Secretary of the Treasury (or the Secretary's delegate), if the person that receives the amount is a partnership or S corporation, any amount excluded from income by reason of the proposal is treated as tax exempt income for purposes of the determination of the basis of a partner's interest in the partnership and the passthrough of items to an S corporation shareholder. The proposal requires the Secretary of the Treasury (or the Secretary's delegate) to prescribe rules for determining a partner's distributive share of any amount so treated as tax exempt income for purposes of determining the basis of a partner's interest in the partnership.