July 2021 Newsletter

Korbitz Financial Planning Newsletter

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Welcome to summer!

I hope this newsletter finds you well and possibly venturing out a little more than this time last year.

Since the American Rescue Plan Act was signed earlier this year I have wanted to share an article about the changes to the Child Tax Credit. Since that article was a must have for this newsletter I decided to focus on topics related to the younger members of your family be they your children, grandchildren, nieces and nephews or other younger adults important to you.

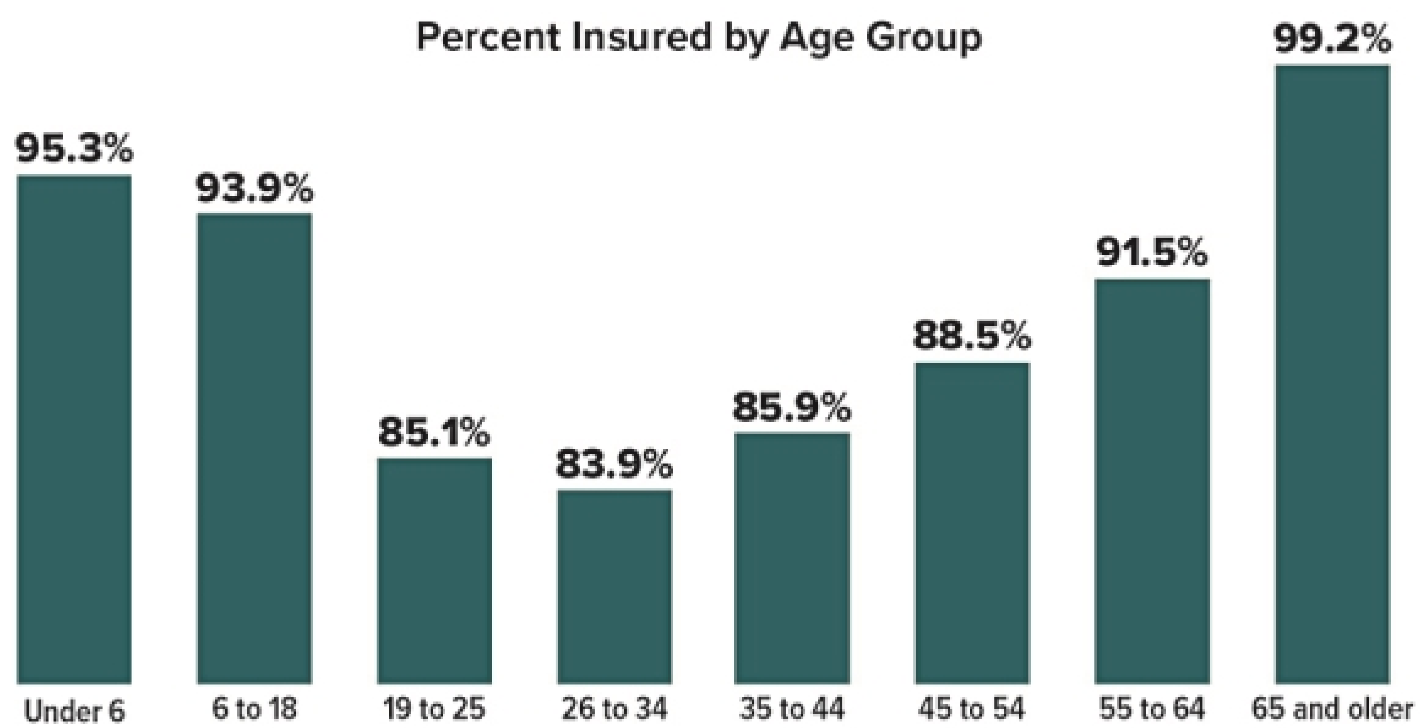
I hope you find these articles informative and as always, feel free to contact me if you have any questions.

All the best for a continued healthy and happy summer!

Eric

Young Adults Are More Likely to Lack Health Coverage

Children are often covered by a parent's health plan or by public health insurance such as the Children's Health Insurance Program (CHIP). But young adults generally lose eligibility for CHIP at age 19 and for coverage under a parent's health plan at age 26. Before they transition into employer-sponsored health plans or buy private health insurance, young adults are more likely to be uninsured than other age groups.



Source: American Community Survey, U.S. Census Bureau, 2020

Child Tax Credit for 2021: Will You Get More?

If you have qualifying children under the age of 18, you may be able to claim a child tax credit. (You may also be able to claim a partial credit for certain other dependents who are not qualifying children.) The American Rescue Plan Act of 2021 makes substantial, temporary improvements to the child tax credit for 2021, which may increase the amount you might receive.

Ages of Qualifying Children

The legislation makes 17-year-olds eligible as qualifying children in 2021. Thus, children ages 17 and younger are eligible as qualifying children in 2021.

Increase in Credit Amount

For 2021, the child tax credit amount increases from $2,000 to $3,000 per qualifying child ($3,600 per qualifying child under age 6). The partial credit for other dependents who are not qualifying children remains at $500 per dependent.

Refundable Credit

The aggregate amount of nonrefundable credits allowed is limited to tax liability. With refundable credits, a taxpayer may receive a refund at tax time if they exceed tax liability. For most taxpayers, the child tax credit is fully refundable for 2021. To qualify for a full refund, the taxpayer (or either spouse for joint returns) must generally reside in the United States for more than one-half of the taxable year. Otherwise, under the pre-existing rules, a partial refund of up to $1,400 per qualifying child may be available. The credit for other dependents is not refundable.

Advance Payments

Taxpayers may receive periodic advance payments for up to one-half of the refundable child tax credit during 2021, generally based on 2020 tax returns. The U.S. Treasury will make the payments for periods between July 1 and December 31, 2021. For example, monthly payments could be up to $250 per qualifying child ($300 per qualifying child under age 6).

Phaseout of Credit

The combined child tax credit (the sum of your child tax credits and credits for other dependents) is subject to phaseout based on modified adjusted gross income (MAGI). Special rules start phasing out the increased portion of the child tax credit in 2021 at much lower thresholds than under pre-existing rules. The credit, as reduced under the special rules for 2021, is then subject to phaseout under the pre-existing phaseout rules.

Phaseout of Credit in 2021 Based on MAGI

Credit can be reduced to $2,000 per qualifying child, or $500 per other dependent, based on MAGI	
Single/Married filing separately	Over $75,000 to $200,000
Married filing jointly	Over $150,000 to $400,000
Head of household	Over $112,500 to $200,000

Credit can be reduced to $0, based on MAGI	
Single/Married filing separately	More than $200,000
Married filing jointly	More than $400,000
Head of household	More than $200,000

For 2021, there no reduction in the credit if the taxpayer's MAGI does not exceed $75,000 ($150,000 for joint returns and surviving spouses, $112,500 for heads of households). The credit is partially phased out for MAGI exceeding these income limits. At this stage, the credit is reduced by the lowest of the following three amounts:

- $50 for each $1,000 (or fraction thereof) of MAGI exceeding these thresholds
- The total increase in the credit amounts for 2021 [e.g., if 3 qualifying children (2 under the age of 6), then $10,200 increased credit minus $6,000 pre-existing credit = $4,200 increase in credit]
- $6,250 ($12,500 for joint returns, $4,375 for heads of households, $2,500 for surviving spouses); these amounts are equal to 5% of the difference between the higher pre-existing phaseout thresholds and the special thresholds for 2021

The credit cannot be reduced below $2,000 per qualifying child or $500 per other dependent at this stage under this special rule for 2021.

However, the credit can be fully phased out for MAGI in excess of $200,000 ($400,000 for a joint return) under the pre-existing phaseout rules. The credit as reduced in the preceding stage is further reduced by $50 for each $1,000 (or fraction thereof) by which the taxpayer's MAGI exceeds these thresholds.

Considerations When Making Gifts to Children

If you make significant gifts to your children or someone else's children (perhaps a grandchild, a nephew, or a niece), or if someone else makes gifts to your children, there are a number of things to consider.

Nontaxable Gift Transfers

There are a variety of ways to make transfers to children that are not treated as taxable gifts. Filing a gift tax return is generally required only if you make gifts (other than qualified transfers) totaling more than $15,000 per individual during the year.

- **Providing support.** When you provide support to a child, it should not be treated as a taxable gift if you have an obligation to provide support under state law. Parents of minor children, college-age children, boomerang children, and special-needs children may find this provision very useful.
- **Annual exclusion gifts.** You can generally make tax-free gifts of up to $15,000 per child each year. If you combine gifts with your spouse, the amount is effectively increased to $30,000.
- **Qualified transfers for medical expenses.** You can make unlimited tax-free gifts for medical care, provided the gift is made directly to the medical care provider.
- **Qualified transfers for educational expenses.** You can make unlimited gifts for tuition free of gift tax, provided the gift is made directly to the educational provider.

For purposes of the generation-skipping transfer (GST) tax, the same exceptions for nontaxable gift transfers generally apply. The GST tax is a separate tax that generally applies when you transfer property to someone who is two or more generations younger than you, such as a grandchild.

Income Tax Issues

A gift is not taxable income to the person receiving the gift. However, when you make a gift to a child, there may be several income tax issues regarding income produced by the property or from sale of the property.

- **Income for support.** Income from property owned by your children will be taxed to you if used to fulfill your obligation to provide support.
- **Kiddie tax.** Children subject to the kiddie tax are generally taxed at their parents' tax rates on any unearned income over $2,200 (in 2021). The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.
- **Basis.** When a donor makes a gift, the person receiving the gift generally takes an income tax basis equal to the donor's basis in the gift. The income tax basis is generally used to determine the amount of taxable gain if the child then sells the property. If instead the property were transferred to the child at your death, the child would receive a basis stepped up (or down) to the fair market value of the property.

Gifts to Minors

Outright gifts should generally be avoided for any significant gifts to minors. For this purpose, you might consider a custodial gift or a trust for a minor.

- **Custodial gifts.** Gifts can be made to a custodial account for the minor under your state's version of the Uniform Gifts/Transfers to Minors Acts. The custodian (an adult or a trust company) holds the property for the benefit of the minor until an age (often 21) specified by state statute.
- **Trust for minor.** A Section 2503(c) trust is specifically designed to obtain the annual gift tax exclusion for gifts to a minor. Principal and income can (but need not) be distributed to the minor before age 21. The minor does generally gain access to undistributed income and principal at age 21. *(The use of trusts involves a complex web of tax rules and regulations, and usually involves upfront costs and ongoing administrative fees. You should consider the counsel of an experienced estate professional before implementing a trust strategy.)*

Transfer by Gift Versus Transfer at Death

Difference in taxable gain when appreciated property is sold at fair market value (FMV) after the transfer.

Calculation Steps	Transfer by Gift	Transfer at Death
Sales price (FMV)	$100,000	$100,000
– Income tax basis	– $20,000 (carryover of donor's basis)	– $100,000 (stepped-up to FMV)
Taxable gain	= $80,000	= $0

New Changes to College Financial Aid and Education Tax Benefits

In late December 2020, Congress passed the Consolidated Appropriations Act, 2021, another relief package in response to the pandemic. The bill included several provisions related to education, including $22.7 billion for colleges and universities. Here are some key highlights.

Simplified FAFSA. The bill accomplishes the long-held bipartisan objective of simplifying the Free Application for Federal Student Aid, or FAFSA, starting with the 2023-2024 school year. For example, the legislation significantly reduces the number of overall questions (including eliminating questions about drug convictions and Selective Service status); makes the income protection allowance more favorable for parents and students, which will allow more income to be shielded from the formula; increases the income threshold (from $50,000 to $60,000) to qualify for the simplified needs test, an expedited formula in the FAFSA that doesn't count family assets; and widens the net of students eligible for a Pell Grant.

However, the FAFSA will no longer divide a parent's assessment by the number of children in college at the same time. This change has the potential to significantly reduce the amount of financial aid offered to middle- and high-income families who have multiple children in college at the same time.

Goodbye EFC terminology. In the future, the expected family contribution (EFC) will be referred to as the student aid index, or SAI, in an attempt to more accurately reflect what this number represents: a yardstick for aid eligibility rather than a guarantee of what families will pay (families often pay more than their EFC amount).

Expanded Lifetime Learning credit. The bill increased the income limits necessary to qualify for the Lifetime Learning credit, an education tax credit worth up to $2,000 per year for courses taken throughout one's lifetime to acquire or improve job skills. Starting in 2021, a full credit will be available to single filers with a modified adjusted gross income (MAGI) below $80,000 and joint filers with a MAGI below $160,000 (the credit phases out for single filers with incomes between $80,000 and $90,000 and joint filers with incomes between $160,000 and $180,000). These are the same income limits used for the American Opportunity credit. To accommodate an expanded Lifetime Learning credit, Congress repealed the deduction for qualified college tuition and fees for 2021 and beyond.

Employer help with student loan repayment. The bill extended a provision allowing employers to pay up to $5,250 of employees' student loans on a tax-free basis for another five years. This provision, included in the Consolidated Aid, Relief, and Economic Security (CARES) Act, would have expired at the end of 2020.