# DESCRIPTION OF SUBTITLE H — SOCIAL SAFETY NET: BUDGET RECONCILIATION LEGISLATIVE RECOMMENDATIONS

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
on September 14, 2021

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

September 11, 2021
JCX-39-21

## CONTENTS

## INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of Subtitle H — Social Safety Net: Budget Reconciliation Legislative Recommendations. 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 Subtitle H — Social Safety Net: Budget Reconciliation Legislative Recommendations* (JCX-39-21), September 11, 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.

## SUBTITLE H — SOCIAL SAFETY NET

### A. Child Tax Credit

### Present Law

**In general**

Taxpayers are allowed a child tax credit for each qualifying child. Due to recent temporary expansions of the child tax credit, different sets of rules apply for taxable years beginning in ("tax years") (i) 2021, (ii) 2022 through 2025, and (iii) after 2025.[2] For tax year 2021, the amount of the child tax credit is $3,000, or $3,600 for children who have not attained the age of 6 as of the close of the calendar year.[3] For tax years 2022 through 2025, the amount of the child tax credit is $2,000.[4] After tax year 2025, the amount of the credit is $1,000.

In tax year 2021, the aggregate amount of otherwise allowable child tax credit is reduced under two separate phaseouts. The initial phaseout applies to taxpayers with modified adjusted gross income ("AGI") over an applicable threshold amount of $150,000 for married taxpayers filing jointly and for surviving spouses, $112,500 for head of household taxpayers, and $75,000 for all other taxpayers.[5] The secondary phaseout applies at higher applicable threshold amounts of $400,000 for taxpayers filing jointly and $200,000 for all other taxpayers.[6] For both phaseouts, 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 initial phaseout is limited so that it only applies to the temporary increased child tax credit amount for 2021 ($1,600 per child under age six and $1,000 per child age six and older); it does not reduce the child tax credit amount below $2,000. For purposes of the modified AGI limitations, 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).[7]

Figure 1 illustrates the 2021 child tax credit by modified AGI for selected combinations of filing status and number of qualifying children.

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[2] For taxable years beginning in 2021, rules enacted in the American Rescue Plan Act (ARPA), Pub. L. No. 117-2, apply. For taxable years 2018 through 2025, temporary rules enacted in Pub. L. No. 115-97 apply, except to the extent they were superseded by temporary rules enacted in ARPA for 2021. After 2025, all temporary child tax credit provisions expire.

[3] Sec. 24(i)(3).

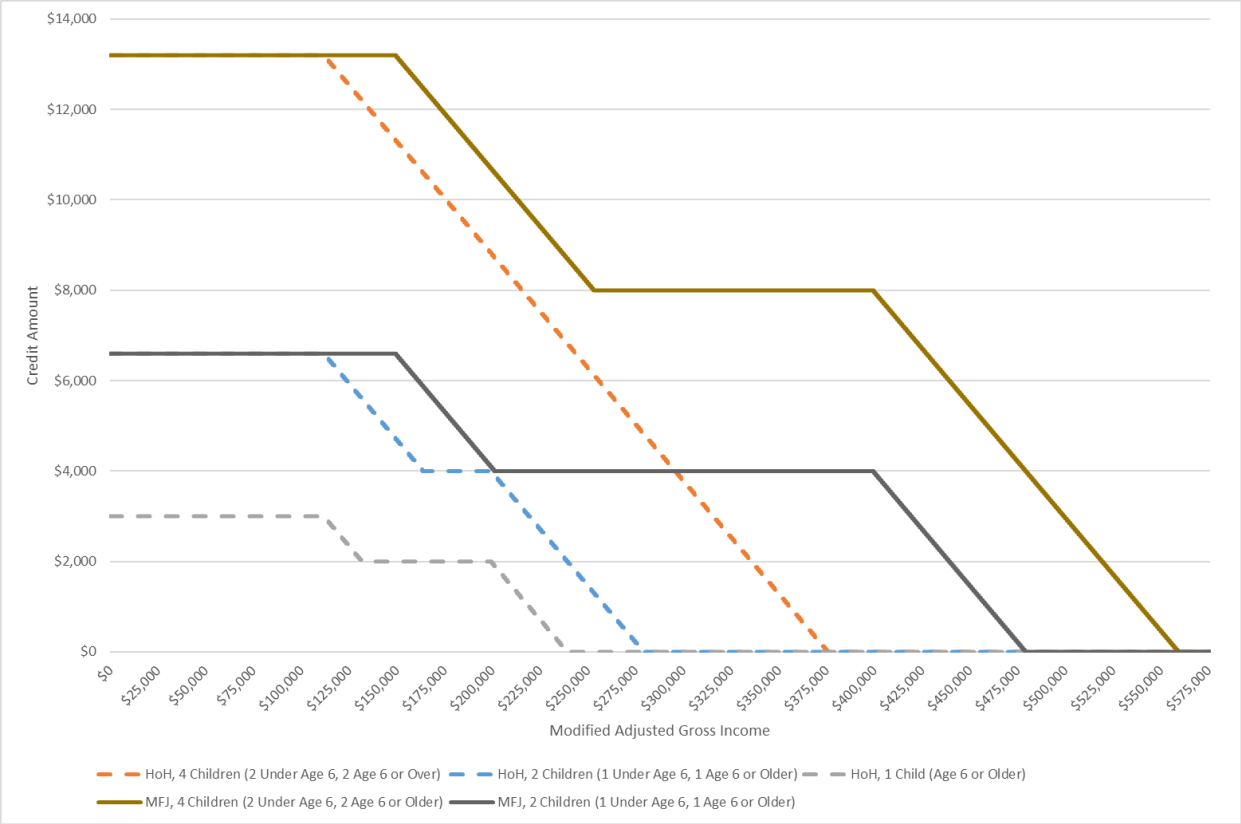
[4] Sec. 24(a), (h)(2).

[5] Sec. 24(i)(4).

[6] Sec. 24(b), (h)(3).

[7] Sec. 24(b)(1).

**Figure 1.– Child Tax Credit for 2021**
**by Modified AGI for Selected Taxpayers***




* Joint Committee staff calculations.

For tax years 2022 through 2025, the initial phaseout is not in effect, so the applicable threshold amounts at which the credit begins to phase out are $400,000 for taxpayers filing jointly and $200,000 for all other taxpayers. For tax years after 2025, the applicable 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.[8]

Through 2025, the name and Social Security number ("SSN") of the qualifying child must appear on the return, and the SSN must be issued before the due date for filing the return.[9] 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.[10] For tax years after 2025, the child tax credit may be claimed if any valid

[8] Sec. 24(b)(2).

[9] Sec. 24(h)(7).

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

taxpayer identification number ("TIN") of the qualifying child, rather than only the SSN of the child, appears on the return.[11] In all years, the TIN of the taxpayer must be issued on or before the due date for filing the return.[12]

**Dependents**

Under section 152, a taxpayer's dependents include both the taxpayer's qualifying children and the taxpayer's qualifying relatives.[13] A dependent must be a citizen, national,[14] or resident of the United States or of a country contiguous to the United States (*i.e.*, Canada or Mexico).[15]

Generally, a qualifying child of a taxpayer is any child who (1) meets the age test,[16] 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.[17] The child also (3) must share the same principal place of abode as the taxpayer for more than one-half of the taxable year,[18] (4) may not have provided over one-half of his or her own support for the taxable year,[19] and (5) may not file a joint return with a spouse.[20] The age test for purposes of determining a qualifying child dependent under section 152 (which differs from the child tax credit age test, as described below) 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

[11] Sec. 24(e)(1).

[12] Sec. 24(e)(2).

[13] Sec. 152.

[14] 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.

[15] Sec. 152(b)(3). There are special rules for certain adopted children.

[16] Sec. 152(c)(1)(C), (c)(3).

[17] Sec. 152(c)(1)(A), (c)(2), (f)(1).

[18] Sec. 152(c)(1)(B).

[19] Sec. 152(c)(1)(D).

[20] Sec. 152(c)(1)(E); see also sec. 152(b)(2).

student,[21] or (3) permanently and totally disabled at any time during the calendar year, regardless of age.[22]

A qualifying relative of a taxpayer is any individual who (1) bears the appropriate relationship to the taxpayer,[23] (2) has gross income for the taxable year that does not exceed the personal exemption amount,[24] (3) receives over one-half of his or her support from the taxpayer,[25] and (4) is not a qualifying child of the taxpayer.[26] A qualifying relative who files a joint return with a spouse does not qualify as a dependent.[27]

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.[28] 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.[29]

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[21] Sec. 152(c)(3), (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.

[22] 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) and 152(c)(3)(B).

[23] Sec. 152(d)(1)(A), (d)(2).

[24] Sec. 152(d)(1)(B). For tax years 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), 85 Fed. Reg. 35233; Notice 2018-70, 2018-38 I.R.B. 441. The personal exemption amount for this purpose is $4,300 for tax year 2021. Rev. Proc. 2020-45, 2020-46 I.R.B. 1016.

[25] Sec. 152(d)(1)(C).

[26] Sec. 152(d)(1)(D).

[27] Sec. 152(b)(2).

[28] Sec. 152(d)(2).

[29] 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.[30] For 2021 only, the age limit was increased to a qualifying child who is under the age of 18.[31] 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.

**Refundability**

Prior to tax year 2021, the child tax credit was partially refundable under two separate formulas as described below. The credit is allowable against both the regular tax and the alternative minimum tax.[32]

For tax year 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.[33] Thus, the child tax credit is generally refundable up to $3,000 (or $3,600) per qualifying child. 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.[34] The modified AGI limitation on the credit still applies (regardless of refundability).

After tax year 2021, the refundable portion of the child tax credit (the "additional child tax credit") is subject to certain limits.[35] For tax years 2022 through 2025, 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").[36] For tax years after 2025, the earned income threshold for the refundable child tax credit is increased to $3,000. 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

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[30] Sec. 24(c). The age requirement must be met at the close of the taxable year. See 2020 Instructions 1040 (rev. April 2021), p.18.

[31] Sec. 24(i)(2).

[32] Sec. 26(a).

[33] 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).

A refundable income tax credit means that 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. See secs. 37, 6401, and 6402. 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. See sec. 6402(a).

[34] 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. Sec. 32(c)(4).

[35] Sec. 24(d).

[36] Sec. 24(d)(1)(B)(i), (h)(6).

employee compensation plus net self-employment earnings.[37] For purposes of the additional child tax credit, only items taken into account in computing taxable income are treated as earned income.[38] However, combat pay that is excluded from gross income under section 112 is also taken into account.

In addition, after 2021, 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.[39] After 2021, there is no principal place of abode requirement for the additional child tax credit.

For tax years 2022 through 2025, the maximum amount of the additional child tax credit is $1,400 per qualifying child.[40] This amount is indexed for inflation, although the amount may not exceed the $2,000 total amount of the child tax credit. For tax years after 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 tax years after 2025.

**Credit for other dependents**

For tax years prior to 2025, a taxpayer 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.[41] For tax years after 2025, there is no tax credit for other dependents.

**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

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[37] Sec. 32(c)(2).

[38] 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.

[39] Sec. 24(d)(1)(B)(ii).

[40] Sec. 24(h)(5).

[41] Sec. 24(h)(4). A child 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 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.

withholding. A taxpayer's withholding allowances take into account the number of children for whom it is reasonably expected that the taxpayer is entitled to a child tax credit.[42]

**Temporary advance payments of the child tax credit**

In general

Effective for tax year 2021, pursuant to section 7527A, the Secretary is directed to establish a program to make periodic advance payments of the child tax credit to eligible taxpayers.[43] In aggregate, the advance payments are to equal the annual advance amount for the calendar year and, in general, are to be made in equal amounts. Monthly advance payments are only to be made for months between July 1, 2021, and December 31, 2021.[44]

The Secretary must make advance payments by electronic funds transfer as if such payments were non-tax Federal payments.[45]

Annual advance amount

A taxpayer's annual advance amount for a calendar year is 50 percent of 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").[46] For purposes of this calculation, (1) the taxpayer's principal place of abode is determined based on the reference year;[47] (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.[48] 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

[42] Sec. 3402(f)(1)(C).

[43] Sec. 7527A(a).

[44] Sec. 7527A(f).

[45] Sec. 7527A(e)(1). Electronic payment requirements for non-tax Federal payments are described in 31 U.S.C. sec. 3332.

[46] Sec. 7527A(b).

[47] 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 information sources. Sec. 7527A(b)(4).

[48] Sec. 7527A(b)(1).

determined.[49] 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 tax year beginning in the preceding calendar year or, if the taxpayer did not file a tax return for that year, the taxpayer's taxable year beginning in the second preceding calendar year.[50] 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 tax year of the return as the new reference year.[51] 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 tax year.[52] 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.[53]

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.[54] A taxpayer may also use the online portal to elect out of advance payments.[55]

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.[56]

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[49] Sec. 7527A(b)(5).

[50] Sec. 7527A(b)(2).

[51] Sec. 7527A(b)(3)(A).

[52] *Ibid.*

[53] Sec. 7527A(b)(3)(B).

[54] Sec. 7527A(c)(2).

[55] Sec. 7527A(c)(1).

[56] 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.[57]

Reconciliation

The amount of the child tax credit allowed for any tax year is reduced by the aggregate advance payments made during the tax year.[58] A failure to so 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 tax year, the taxpayer's tax liability for the taxable year is increased by the excess amount.[59] This increase in tax liability is not considered to be part of a taxpayer's regular tax liability.[60] 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.[61]

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.[62] 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.

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[57] Sec. 7527A(e)(3).

[58] Sec. 24(j)(1).

[59] Sec. 24(j)(2).

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

[61] 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 amount is $0 if 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.

[62] Sec. 7527A(g).

**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 a mirror child tax credit because they have their own internal revenue laws.

Prior to 2021, residents of the territories with three or more qualifying children could receive the additional child tax credit under the alternative formula in the U.S. Code. The U.S. Treasury historically has made payments to each territory other than Puerto Rico to cover the cost of this credit. Residents of Puerto Rico could claim the additional child tax credit under the alternative formula by filing a Form 1040-SS or Form 1040-PR with the IRS.

Application of the child tax credit in the territories beginning in 2021

Beginning in 2021, 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. These payments reflect the full child tax credit, not just the additional child tax credit under the alternative formula.

The Secretary must 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.[63] This amount is determined by the Secretary based on information provided by the government of the territory. Because of their mirror Codes, the temporary changes to the child tax credit 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.

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.[64] 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.

For tax years after 2021, bona fide residents of Puerto Rico may claim an additional child tax credit up to the maximum amount[65] from the U.S. Treasury under the alternative formula, but

[63] Sec. 24(k)(1).

[64] Sec. 24(i)(1).

[65] This amount is $1,400 for taxable years beginning in 2021, prior to being increased by ARPA.

determined without regard to the requirement that the taxpayer have three or more children, by filing a return with the IRS.[66]

The Secretary must 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.[67] These amounts include, for 2021, amounts resulting from the temporary expansion of the child tax credit. The Secretary is prohibited 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.

Each of the mirror Code territories and American Samoa may elect to provide territory residents with advance payments of the child tax credit, as administered by the territory government.[68] The Secretary shall provide administrative expenses to a territory making such election.[69] The child tax credit advance payment program does not apply to Puerto Rico.[70]

## Description of Proposal

### Modifications applicable beginning in 2021

For tax year 2021, the proposal makes several modifications to the child tax credit and advance payment rules. First, recapture is allowed without taking into account the safe harbor amount for a child if the Secretary determines that the child was taken into account in determining the annual advance amount due to fraud by the taxpayer or intentional disregard of rules and regulations by the taxpayer. For this purpose, intentional disregard of the rules and regulations includes, with respect to any child taken into account in determining the annual advance amount of a taxpayer, such taxpayer entering into a plan or other arrangement with, or expecting, another taxpayer to take the child into account in determining the credit for the tax year.

The proposal also provides a rule regarding advance payments with respect to a joint return by treating half of such payment as being made to each individual filing the return.

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[66] Sec. 24(k)(2).

[67] Sec. 24(k)(3).

[68] Sec. 7527A(e)(4)(B), (C).

[69] Sec. 7527A(e)(4)(C).

[70] Secs. 24(k)(2)(A)(ii) and 7527A(e)(4)(A).

Finally, the proposal clarifies that the annual advance amount used to make advance payments may be determined based on other information known to the Secretary.

Each of these modifications also will apply for tax year 2022.

**Extension and modification of child tax credit, modification of other dependent credit, and advance payment for 2022**

The proposal extends many of the ARPA expansions that otherwise expire after 2021 through tax year 2022. These extensions include (i) full refundability for taxpayers who have a principal place of abode in the United States for more than one-half of the year or who are bona fide residents of Puerto Rico for the tax year, (ii) the increase in the age limit of a qualifying child for purposes of the child tax credit to include children who have not attained age 18, (iii) the increase in child tax credit amount to $3,000, and $3,600 for qualifying children who have not attained the age of 6, (iv) the application of the initial phaseout to the increased child tax credit amount at the following applicable threshold amounts: $150,000 for taxpayers filing jointly or surviving spouses, $112,500 for head of household taxpayers, and $75,000 for all other taxpayers, and (v) certain rules regarding payments to the territories and payments directly to the territory residents with respect to the child tax credit.

The proposal changes the modified AGI used for purposes of the income phaseout of the credit to be the modified AGI of the taxpayer for the preceding tax year (2021) if such modified AGI is less than the modified AGI of the current tax year (2022).

Under the proposal, for tax year 2022, the child tax credit may be claimed if any valid taxpayer identification number ("TIN") of the qualifying child, rather than only the SSN of the child, appears on the return. The TIN must be issued on or before the due date of the return.

For purposes of reconciling the aggregate advance payments with the child tax credit, the safe harbor amount for tax year 2022 is $3,000 ($3,600 in the case of a qualifying child who has not attained age 6) for each qualifying child taken into account in determining the annual advance amount with respect to the taxpayer for months beginning in the tax year, but not taken into account in determining the credit allowed to such taxpayer for the tax year.

The proposal also adjusts the $3,000 and $3,600 child tax credit amounts, the $500 other dependent credit, and the child tax credit initial phaseout thresholds for inflation, from 2021, beginning in 2022. The new safe harbor amount is also adjusted for inflation to match the child tax credit amounts. The inflation adjustment is made using the CPI (as opposed to the chained CPI).

The proposal also extends advance payments of the child tax credit under section 7527A through December 31, 2022, and removes the 50 percent limit on the annual advance amount

that was applicable for 2021. Accordingly, advance payments will be made for the full year in 2022, rather than one-half of the year as in 2021.[71]

**Establishment of monthly child tax for 2023 through 2025**

The proposal creates, for tax years 2023 through 2025, a new monthly refundable child tax credit in section 24A in lieu of the existing child tax credit in section 24.[72] The credit allowed for the tax year is the sum of the monthly specified child allowances for the taxpayer for each calendar month during the tax year. The monthly specified child allowance for any month is $250 for each specified child, or $300 for each specified child will not, as of the close of the tax year which includes such month, have attained age six.

The credit is fully refundable for any month for which the taxpayer (in the case of a joint return, either spouse) has a principal place of abode in the United State or Puerto Rico for more than one-half of the calendar month.[73]

A central feature of the new monthly child tax credit is the requirement of the taxpayer to establish presumptive eligibility. Presumptive eligibility, as described in detail below, allows a child to be treated as the specified child of a taxpayer and therefore allows a taxpayer to claim a monthly child tax credit and receive advance payments for such child. In addition, presumptive eligibility provides protection from recapture. Advance payments generally may not be recaptured unless they are made outside of a period of presumptive eligibility (for example, because the taxpayer was found to have committed fraud or intentionally disregarded rules or regulations in establishing presumptive eligibility or because a child moved and another taxpayer established presumptive eligibility).

Monthly specified child allowance

The monthly specified child allowance is reduced under two separate phaseouts. The initial phaseout applies to taxpayers with modified AGI over an applicable threshold amount of $150,000 for married taxpayers filing jointly and for surviving spouses, $75,000 for married individuals filing a separate return, and $112,500 for all other taxpayers. The secondary phaseout applies at higher applicable threshold amounts of $400,000 for taxpayers filing jointly and for surviving spouses, $300,000 for head of households, and $200,000 for all other taxpayers. For both phaseouts, the amount of monthly child tax credit is reduced by 1/12 of five percent of the excess (if any) of modified AGI for the applicable taxable year over the applicable threshold amount. However, the initial phaseout is limited so that it does not reduce the monthly

[71] The Secretary remains obligated to take the receipt of advance payments of the child tax credit into account in determining the rules regarding withholding allowances.

[72] During this period the existing child tax credit in section 24 does not apply.

[73] All determinations of principal place of abode under the proposal are determined as provided in section 32.

specified child allowance below $166.67.[74] For purposes of the modified AGI limitations, 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).

Modified AGI for the applicable taxable year means the tax year for which the taxpayer has the lowest modified AGI among the current tax year and the two preceding tax years.

The proposal adjusts the monthly specified child allowance and the initial phaseout thresholds for inflation, from 2021, beginning in tax year 2023 and using the CPI. The proposal reflects that the annualized monthly specified child allowance for a specified child is the $3,000 (or $3,600 for qualifying or specified children who have not attained the age of 6) first in effect for 2021, adjusted consistently for inflation in each subsequent year.

Specified child

Under the proposal a specified child with respect to a taxpayer for a calendar month is defined as a child:

1. Who has the same principal place of abode as the taxpayer for more than one-half of the month,

2. Who is younger than the taxpayer and will not, as of the close of the tax year which includes such month, have attained age 18,[75]

3. Who receives care from the taxpayer during the month that is not compensated,

4. Who is not the spouse of the taxpayer during the month,

5. Who is not a taxpayer with respect to whom any child is a specified child for the month, and

6. Who is either a citizen, national, or resident of the United States, or, if the taxpayer is a citizen or national of the United States, who is legally adopted by the taxpayer or is lawfully placed with the taxpayer for legal adoption by the taxpayer

In determining principal place of abode, a temporary absence is treated as a day at the child's principal place of abode and not a day at any other location. An absence is treated as temporary if the child would have resided at the place of abode but for the absence and it is reasonable to assume that the child will return to reside at the place of abode.

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[74] Thus, the annualized amount for a specified child cannot be reduced below $2,000 under the initial phaseout.

[75] A taxpayer receives no monthly specified child allowances for any months in the calendar year during which a child turns 18 years old, meaning credits may be made for a total of 18 years for a given child (12 months for each calendar year during which the child is age zero to 17).

The proposal provides that, except as otherwise provided by the Secretary, whether a child receives care from the taxpayer is a facts and circumstances determination based on the following factors: (i) the supervision provided by the taxpayer regarding the daily activities and needs of the child, (ii) the maintenance by the taxpayer of a secure environment at which the child resides, (iii) the provision or arrangement by the taxpayer of, and transportation by the taxpayer to, medical care for the child at regular intervals and as required, (iv) the involvement by the taxpayer in, and financial and other support by the taxpayer for, educational or similar activities of the child, and (v) any other factor that the Secretary determines appropriate. For determining whether care is compensated, compensation from the Federal government, a State or local government, a tribal government, or territorial government is not taken into account.

The proposal provides special rules regarding the birth and death of a specified child. In the case of a birth, the child is treated as a specified child of the relevant taxpayer for each month in the calendar year that precedes the first calendar month that the child is a specified child with respect to any taxpayer. That is, a taxpayer properly claiming a newborn may receive a monthly specified child allowance for the entire year of the birth (*e.g.*, a December birth results in 12 monthly allowances for the year of birth).[76] In the case of death, the child is treated as a specified child of the relevant taxpayer for each month in the calendar year that follows the last month the child is alive. The relevant taxpayer is the first (in the case of birth) or last (in the case of death) taxpayer for whom the child is a specified child.

Tie-breaking rules

The proposal provides for tie-breaking rules similar to tie-breaking rules in section 152, but with certain modifications. Under the proposal, if a child would otherwise be a specified child with respect to more than one individual for a month (*e.g.*, a child lives with his or her mother and grandmother in the same residence) and more than one taxpayer claims the credit with respect to that child, then the following rules apply. First, if only one of the individuals claiming the child as a specified child is the child's parent, the child is treated as the specified child of the parent. Second, if the child is not a specified child of any parent, the child is treated as the specified child of the specified relative with the highest AGI for the tax year that includes the month at issue.[77] Third, if the child is not a specified child of any parent or specified relative, the child is treated as the specified child of the taxpayer claiming the child with the highest AGI for the tax year that includes the month at issue. Fourth, if both parents claim the child and the parents do not file a joint return, then the child is deemed a specified child first with respect to the parent with whom the child resides for the longest period of time during the month, and second with respect to the parent with the highest AGI for the tax year that includes the month at issue. If a parent of the child elects not to treat the child as a specified child for the month, then such parent is disregarded in applying the tie-breaking rules if the claimant's AGI is higher than

[76] Thus, a specified child, regardless of when the child is born during the year, will have the same number of (i) total months for which the child may be claimed for the credit for children under 6 and (2) total months for which the child may be claimed for the credit.

[77] A specified relative for this purpose is (i) an ancestor of a parent of the specified child, (ii) a brother or sister of a parent of the specified child, or (iii) a brother, sister, stepbrother, or stepsister of the specified child.

the highest AGI of any parent of the child for the tax year that includes the month at issue.[78] A similar rule applies for specified relatives electing not to treat the child as a specified child for the month.

Rules similar to the special rules provided for divorced parents in section 152(e) apply for purposes of the proposal. In general, these rules allow divorced parents to share the child tax credit by agreement. In addition, the rules for missing children in section 152(f)(6) apply for purposes of the proposal.

Presumptive eligibility

In determining specified child status, the proposal provides that if a period of presumptive eligibility has been established under the advance payment rules in proposed section 7527B for a child with respect to a taxpayer, then the child is treated as the specified child of such taxpayer for any month in the period of presumptive eligibility, and is not treated as the specified child of any taxpayer for whom a period of presumptive eligibility has not been established. If a taxpayer does not elect to receive advance payments, such taxpayer is not precluded from establishing a period of presumptive eligibility for any specified child for purposes of claiming the monthly child tax credit on a tax return.

Identification requirement

The proposal provides that the name and TIN of the specified child must appear on the return, and the TIN must be issued on or before the due date for filing the return. In addition, the TIN of the taxpayer must be issued on or before the due date for filing the return for the tax year.

Disallowance for prior fraudulent, reckless, or improper claims

The monthly child tax credit and advance payments of the credit are disallowed for certain periods after a taxpayer has made a fraudulent, reckless, or other improper claim for the credit. If there is a final determination that a taxpayer's claim of the monthly child tax credit or receipt of advance payment is fraudulent, the taxpayer is not allowed the monthly child tax credit or advance payment for any period beginning on the date of the final determination and for the 10 taxable years after the year of the fraudulent claim. If there is a final determination that a taxpayer's claim of the monthly child tax credit or receipt of advance payment is due to reckless or intentional disregard of rules and regulations, the taxpayer is not allowed the monthly child tax credit or advance payment for any period beginning on the date of the final determination and for the two taxable years after the reckless claim. If a taxpayer makes a monthly child tax credit claim that is not determined to be fraudulent or reckless but that is denied under the deficiency procedures of subchapter B of chapter 63 of the Code, the taxpayer is not allowed the monthly child tax credit for any subsequent year and the advance payments for any subsequent month

[78] Thus, for example, if a child would otherwise be the specified child of a parent and grandparent for a month, and the grandparent has a higher AGI for the tax year that includes the month, the parent may elect not to treat the child as a specified child, allowing the child to be the specified child of the grandparent. If the parent has a higher AGI for the tax year that includes the month, no such election is allowed.

unless the taxpayer provides such information that the Secretary may require to demonstrate eligibility for the credit.

**Advance payment of the monthly child tax credit for 2023 through 2025**

For tax years 2023 through 2025, pursuant to proposed section 7527B, the Secretary is directed to establish a program to make monthly advance child payments of the monthly child tax credit.

Monthly advance child payment

The monthly advance child payment with respect to a taxpayer for a calendar month is the amount estimated by the Secretary as the monthly specified child allowance under proposed section 24A (monthly child tax credit) for the taxpayer for the calendar month, but calculated based on a reference month and a reference taxable year. For purposes of this calculation, (1) unless determined by the Secretary, based on any information known to the Secretary, the taxpayer is treated as having only the specified children the taxpayer had for the reference month; (2) unless determined by the Secretary, based on any information known to the Secretary, the ages of such children (and the status of such children as specified children) are determined by taking into account the passage time since the reference month; (3) the taxpayer's modified AGI for the reference taxable year, rather than the applicable taxable year, is used to determine any phaseout of credit; and (4) unless determined by the Secretary, based on any information known to the Secretary, no monthly specified child allowance is determined for the taxpayer unless the taxpayer (in the case of a joint return, either spouse) has a principal place of abode in the United States or Puerto Rico for more than one-half of the reference month.

The name and TIN of the specified child must be provided on the tax return for the reference taxable year or via a specified alternative mechanism (if information for purposes of advance payments was provided via a specified alternative mechanism).[79]

A specified child is not taken into account for the monthly advance child payment if the child is deceased as of the beginning of the calendar year that includes the month at issue if the Secretary knows of the child's death as of date on which the Secretary estimates the monthly payment. Thus, for 2023, a child that is known to the Secretary as being deceased as of January 1, 2023, is not taken into account for any monthly advance child payment in 2023.

For purposes of determining monthly advance child payments, the refence month with respect to any taxpayer for any calendar month is the most recent of (i) in the case of a taxpayer who filed a tax return for the last tax year ending before the calendar month, the last month of the tax year, (ii) in the case of a taxpayer who filed a tax return for the tax year preceding the last tax year ending before the calendar month, the last month of the preceding tax year, and (iii) in the case of a taxpayer who provided information through a specified alternative mechanism which is sufficient to estimate the taxpayer's monthly advance child payment for the month, such month. The reference taxable year is the most recent of (i) the taxpayer's last taxable year ending before the calendar month, (ii) the tax year preceding the last taxable year ending before the calendar

[79] In addition, the TIN must be issued on or before the due date for filing the return for the tax year.

month, or (iii) in the case of a taxpayer who provided information through a specified alternative mechanism which is sufficient to estimate the taxpayer's modified AGI for the tax year that includes such month, such tax year.

No month or year described above shall be taken into account for purposes of determining the reference month or reference taxable year unless all relevant information is available to the Secretary and the Secretary has adequate time to make estimates on the basis of the information before the beginning of the calendar month at issue. If the taxpayer has not provided sufficient information under any of the methods described above, the monthly advance child payment is zero, unless the Secretary determines that the Secretary can make estimates on the basis of reasonably reliable information known to the Secretary.

The Secretary is directed to create an on-line portal to allow taxpayers to provide information regarding the monthly advance child payment, including (1) the number of the taxpayer's specified children, including by reason of the birth of a specified child; (2) the taxpayer's marital status; (3) the taxpayer's income; (4) the taxpayer's principal place of abode, and (4) any other factors that the Secretary may provide. A taxpayer may also use the on-line portal to elect in or out of advance payments.

A specified alternative mechanism includes the on-line portal described above, the on-line portal established for purposes of advance payments of the child tax credit under section 7527A, and any other mechanism or method established by the Secretary to allow taxpayers to provide the information described above for the on-line portal. Such mechanism includes the filing of a tax return.

Presumptive eligibility for monthly advance child payments

In addition to the above rules, a child shall be treated as a specified child of a taxpayer for purposes of determining the monthly advance child payment for a month only if the month is part of a period of presumptive eligibility for the taxpayer. A taxpayer establishes presumptive eligibility with respect to a specified child for a month at the time and in the manner provided by the Secretary. Except as otherwise provided by the Secretary, to establish the period of presumptive eligibility for a specified child, the taxpayer must express a reasonable expectation and intent that the taxpayer will continue to be eligible with respect to the specified child for at least two months following the month for which presumptive eligibility is established. Presumptive eligibility may be established by providing information on the prior-year tax return, through the on-line portal, or in such other manner as the Secretary may provide.

Except as otherwise provided by the Secretary, a period of presumptive eligibility begins with the month for which presumptive eligibility is established and ends with the earliest of (i) the beginning of that same month if the Secretary determines the taxpayer committed fraud or intentionally disregarded rules or regulations in establishing presumptive eligibility (*i.e.*, no presumptive eligibility), (ii) in the case of notification from the Secretary that the period of presumptive eligibility has been terminated or suspended because of a question regarding the taxpayer's eligibility, the month specified in the notification as when termination or suspension begins, and (iii) the month following any failure of the taxpayer to make the required annual

renewal of presumptive eligibility by the date prescribed by the Secretary. Periods of presumptive eligibility include any period of hardship or grace period as described below.

Under the proposal, the Secretary shall issue regulations or other guidance to establish procedures to the maximum extent administratively feasible allowing for automatic presumptive eligibility for the birth of a child. In addition, the Secretary shall issue regulations or other guidance to establish procedures allowing for automatic presumptive eligibility, and termination of such eligibility, for a parent or specified relative of a child based on information provided to the Secretary by one or more government entities.

If a taxpayer's period of presumptive eligibility ends because of a failure to make the required annual renewal of presumptive eligibility, the Secretary shall provide written notice to the taxpayer.

Specified child of more than one taxpayer

In the event of competing claims for a monthly advance child payment with respect to a specified child by more than one taxpayer for the same calendar month, the child shall be taken into account only by the taxpayer with the most recent reference month. If more than taxpayer has the same reference month, or if any taxpayer uses the specified alternative method to receive the monthly advance payment for a specified child of another taxpayer, the Secretary shall establish procedures under which the Secretary expeditiously adjudicates the competing claims of presumptive eligibility. The procedures shall provide for an expedited process and for appeals.

The Secretary may make a one-time retroactive payment following the adjudication of a competing claim if the Secretary determines that a child is a specified child of a taxpayer and the Secretary did not make payments to the taxpayer with respect to the child during the period of the determination. The retroactive payment shall be limited to the increase in the aggregate amount of monthly advance child payments that the taxpayer would have received during the determination period if the determination had been made immediately.

If the Secretary makes payments during the determination period with respect to a child, the Secretary shall provide notice to each taxpayer that such payments may be subject to recapture. Upon making a determination to resolve competing claims, the Secretary shall determine whether any such payments should be subject to recapture and notify the affected taxpayers.

The proposal provides for information sharing with other Federal agencies; State, local, tribal, and territorial governments; and other individuals or entities as appropriate for purposes of adjudicating a competing claim. Such an adjudication shall not be treated as an assessment, examination, or inspection of the taxpayer for purposes of administrative provisions in the Code.[80]

[80] See secs. 6201 and 7605(b).

Grace periods and hardships

In the event of a failure or delay in establishing presumptive eligibility for a specified child, a taxpayer may elect to receive a retroactive advance payment or monthly child tax credit for a period of up to three months. The grace-period payment or credit is allowed to a taxpayer only once in a 36-month period. No grace-period payment or credit may be made or allowed in the event of fraud or reckless or intentional disregard of rules and regulations.

In the event of a failure or delay in establishing presumptive eligibility for a specified child due to hardship, a taxpayer is allowed a retroactive advance payment or monthly child tax credit for a period of up to six months. A hardship includes domestic violence, serious illness, natural disaster, or any other hardship, as determined by the Secretary.

Reconciliation of credit and monthly advance child payments

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

If a taxpayer is subject to recapture and receives advance payments in excess of the taxpayer's allowable monthly child tax credit during a tax year, the taxpayer's tax liability for the tax year is increased by the excess amount. This increase in tax liability is not considered to be part of a taxpayer's regular tax liability.[81] Taxpayers are subject to recapture if they are described in any of the following:

1. The Secretary determined that the aggregate amount of advance payments with respect to the taxpayer for the tax year was determined on the basis of fraud or reckless or intentional disregard of rules and regulations.

2. The aggregate amount of advance payments with respect to the taxpayer for the tax year was determined on the basis of modified AGI that was less than the taxpayer's modified AGI for appliable taxable year (the lowest modified AGI of the current tax year and the two preceding tax years). The amount subject to recapture is limited to the increase in advance payments due to the use of the lower modified AGI. A similar rule applies if the aggregate amount of advance payments with respect to the taxpayer for the tax year was determined on the basis of a filing status that differs from the taxpayer's filing status for the applicable tax year.

3. An advance payment was made to a taxpayer with respect to a child for a month which was not part of a period of presumptive eligibility for the child. The amount subject to recapture is limited to the amount of advance payments made outside of a period of presumptive eligibility.

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

4. The Secretary notifies the taxpayer under procedures established to adjudicate competing claims of presumptive eligibility with respect to the same child that the taxpayer is subject to recapture with respect to certain advance payments. The amount subject to recapture is limited to the aggregate amount of such payments.

5. The taxpayer has a principal place of abode in the United States or Puerto Rico for more than one-half of one or more calendar months during the tax year but does not have such a principal place of abode for all calendar months during the tax year, pursuant to regulations or other guidance issued by the Secretary for purposes of minimizing advance payments made to ineligible individuals.

6. Other recapture circumstances described in regulations or other guidance issued by the Secretary to facilitate administration and enforcement of advance payments and to minimize the amount of advance payments made to ineligible individuals and to prevent abuse.

The proposal also provides a rule regarding advance payments with respect to a joint return by treating half of such payment as being made to each individual filing the return.

Administrative provisions

The Secretary must make advance payments by electronic funds transfer as if such payments were non-tax Federal payments.[82]

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.[83]

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. If the Secretary has determined that any payments made to the taxpayer are subject to recapture, the notice shall include the amounts subject to recapture.

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

The monthly advance payment program established pursuant to proposed section 7527B terminates for any month beginning after December 31, 2025.

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[82] Electronic payment requirements for non-tax Federal payments are described in 31 U.S.C. sec. 3332.

[83] See rules in sec. 6402(c) through (f).

**Application of the monthly child tax credit and advance payments in the territories for 2023-2025**

Under the proposal, the Secretary must make payments to each territory, with the exception of Puerto Rico, that relate to the cost or approximate cost of that territory's monthly child tax credit or make payments of the credit directly to territory residents for tax years 2023 through 2025. Puerto Rican residents claim the credit directly from the IRS.

The Secretary must 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 monthly child tax credit to the territory's mirror Code for the taxable year. This amount is determined by the Secretary based on information provided by the government of the territory. No monthly child tax credit under the Internal Revenue Code is permitted for any resident of a mirror Code territory with respect to whom a monthly child tax credit is allowed against income taxes of the territory.

For 2023 through 2025, the monthly child tax credit is made fully refundable for taxpayers with a principal place of abode in Puerto Rico for more than one-half of any calendar month during the tax year, claimed by filing a tax return with the IRS. In addition, such taxpayers may receive advance payment of the monthly child tax credit from the IRS.

The Secretary must 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 monthly child tax credit if a mirror Code tax system had been in effect in American Samoa in 2023 through 2025. The Secretary is prohibited 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 monthly 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 tax year, a taxpayer with a principal place of abode in American Samoa for more than one-half of any calendar month during the tax year may claim a monthly child tax credit by filing a return with the IRS under rules similar to those for Puerto Rico, described above.

Each of the mirror Code territories and American Samoa may elect to provide territory residents with advance payments of the monthly child tax credit for tax years 2023 through 2025, as administered by the territory government. The Secretary shall provide administrative expenses to a territory making such election.

**Regulatory authority**

The Secretary is directed to issue regulations or other guidance the Secretary determines is necessary or appropriate to carry out the purposes of the monthly child tax credit. This includes regulations or other guidance (1) for determining whether an individual receives care from a taxpayer for purposes of the specified child definition, and (2) to coordinate or modify the application of the monthly child tax credit with the child tax credit under section 24 and the advance payment provisions in section 7527A and proposed section 7527B, (i) in the case of any taxpayer whose tax year is other than a calendar year, (ii) whose filing status for a tax year is

different from the status used for determining advance payments during such tax year, or (iii) whose principal place of abode for any month is different than the principal place of abode used for determining the monthly advance payment for such month.

**Credit for certain other dependents**

For tax years 2023 through 2025, the proposal modifies the existing credit for other dependents by creating a new credit in proposed section 24B with similar rules to the existing credit. Under the proposal, a taxpayer is allowed a $500 nonrefundable credit for each dependent of the taxpayer as defined in section 152, other than a specified child as defined for purposes of the monthly child tax credit. In addition, the dependent must be a citizen, national, or resident of the United States. The $500 credit amount is indexed for inflation, from 2021, beginning in 2023 and using the CPI.[84]

The credit for other dependents is reduced by $50 for each $1,000 (or fraction thereof) of modified AGI over the threshold amount. The threshold amounts are $400,000 for taxpayers filing jointly and for surviving spouses, $300,000 for head of households, and $200,000 for all other taxpayers. The phaseout is separate from the monthly child tax credit phaseout of proposed section 24A.

The proposal provides that the name and TIN of the dependent must appear on the return, and the TIN must be issued on or before the due date for filing the return. In addition, the TIN of the taxpayer must be issued on or before the due date for filing the return.

For tax years after 2025, there is no tax credit for other dependents.

**Refundable child tax credit after 2025**

For tax years after 2025, the child tax credit under section 24 is made fully refundable for taxpayers (in the case of a joint return, either spouse) who have a principal place of abode in the United States for more than one-half of the tax year. The credit is also fully refundable for taxpayers who are bona fide residents of Puerto Rico and, in the absence of a plan by American Samoa to administer its own child tax credit program, who are bona fide residents of American Samoa. Bona fide residents of Puerto Rico and American Samoa (in the absence of a plan by American Samoa to administer its own program) may claim the credit directly from the Secretary.

The proposal does not modify the current law requirement that the Secretary continue its cover over to the mirror Code territories and (if it has a plan to administer its own program) American Samoa.

There is no provision for advance payments after 2025.

[84] The policy reflects that the credit amount of $500 is first adjusted for inflation in 2022, and then adjusted consistently for inflation in each subsequent year.

## Effective Date

The proposal modifying the child tax credit rules for 2021 is effective for taxable years beginning, and payments made, after December 31, 2020.

The proposal providing a one-year extension of the ARPA expansions of the child tax credit (*i.e.*, for 2022) is effective for taxable years beginning, and payments made, after December 31, 2021.

The proposal providing for establishment of a monthly child tax credit through 2025 is effective for taxable years beginning after December 31, 2022. The proposal providing for advance payments of such credit is effective for payments made for calendar months beginning after December 31, 2022.

The proposal providing for a refundable child tax credit after 2025 is effective for taxable years beginning after December 31, 2025.

## B. Child and Dependent Care Tax Credit

### 1. Certain improvements to the child and dependent care credit made permanent

**Present Law**

**Child and dependent care tax credit**

General structure

Under section 21, a taxpayer with one or more qualifying individuals may claim a credit against income tax liability for employment-related expenses for child and dependent care.[85] For this purpose, employment-related expenses are expenses for household services and expenses for the care of a qualifying individual.[86] These expenses must be incurred to enable the taxpayer to be gainfully employed during any period for which there are one or more qualifying individuals with respect to the taxpayer.

The amount of employment-related expenses that may be taken into account for purposes of the credit is subject to a limitation. The applicable limitation is reduced by any amount excluded from income under an employer-provided dependent care assistance program under section 129.

Generally, a qualifying individual is: (1) a dependent[87] of the taxpayer 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.[88] Married taxpayers must file a joint return in order to claim the credit.

Credit for 2021

For taxable years beginning in 2021, the credit is refundable for a taxpayer who has a principal place of abode in the United States for more than one half of the taxable year.[89] In the case of a joint return, refundability is allowed if at least one spouse satisfies the principal place of

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[85] Sec. 21.

[86] Sec. 21(b)(2). Expenses do not include amounts paid for a camp where a qualifying individual stays overnight. Household services are the performance in and about the taxpayer's home of ordinary and usual services necessary to the maintenance of the household and attributable to the care of the qualifying individual. Treas. Reg. sec. 1.21-1(d)(3).

[87] See sec. 152 for the definition of dependent.

[88] Sec. 21(b)(1).

[89] Sec. 21(g)(1).

abode requirement. Principal place of abode is determined as provided in section 32.[90] A taxpayer who does not satisfy the principal place of abode requirement may still be able to claim a nonrefundable credit.

The amount of the credit is 50 percent of employment-related expenses up to a limitation of $8,000 in the case of one qualifying individual and $16,000 if there are two or more qualifying individuals.[91] 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 credit is subject to a two-part phaseout to the 50-percent credit rate.[92] 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 adjusted gross income ("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 2 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 expenses ($8,000 and $16,000, respectively).[93]

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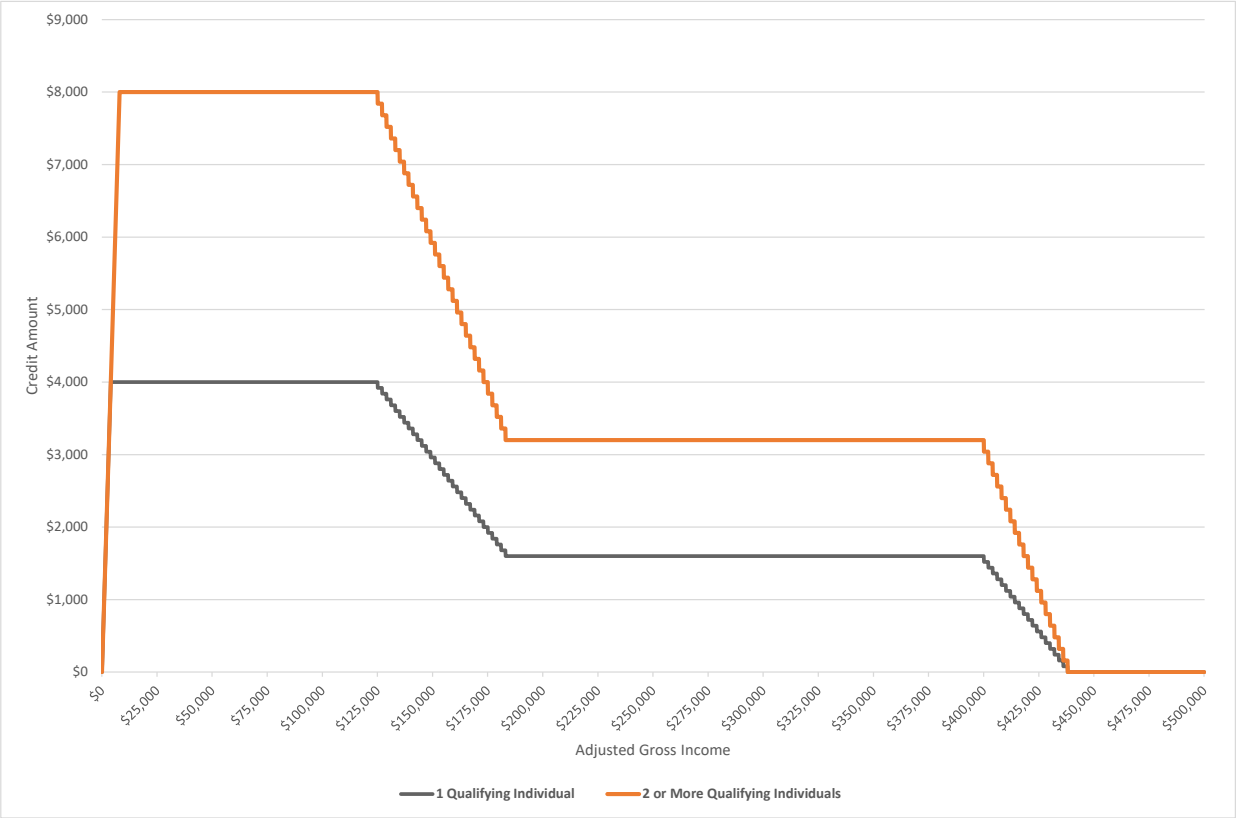
[90] Thus, a member of the Armed Forces of the United States stationed outside the United States while serving on extended active duty is treated as having a principal place of abode in the United States.

[91] Sec. 21(g)(2), (3).

[92] Sec. 21(g)(4).

[93] Figure 1 assumes AGI and earned income are equal for these taxpayers.

**Figure 2.– Child and Dependent Care Tax Credit for 2021 by AGI for Selected Taxpayers***




* Joint Committee staff calculations.

Credit for years after 2021

For taxable years beginning after 2021, the credit is nonrefundable. A taxpayer's employment-related 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.[94] The maximum credit rate is 35 percent. Thus, the maximum credit is $1,050 if there is one qualifying individual and $2,100 if there are two or more qualifying individuals.

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.[95] Thus, for taxpayers with AGI above $43,000, the credit rate is 20 percent, and the maximum credit is $600 if the taxpayer has one qualifying individual or $1,200 if the taxpayer has two or more qualifying individuals. The phaseout threshold and the amount of expenses eligible for the credit are not indexed for inflation.

[94] Sec. 21(c).

[95] Sec. 21(a).

Earned income limitation

Employment-related expenses generally cannot exceed the taxpayer's earned income.[96] In the case of a joint return, expenses cannot exceed the earned income of the spouse with the least earned income.

A special rule applies in the case of a joint return, where one spouse is either (1) a full-time student or (2) 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 of the year. Under this rule, for each month in which the student or incapacitated spouse qualifies, the spouse is deemed to have $250 of earned income in the case of one qualifying individual and $500 if there are two or more qualifying individuals.[97] Thus, if the spouse qualifies under the rule for 12 months, the spouse is deemed to have $3,000 in the case of one qualifying individual and $6,000 if there are two or more qualifying individuals, equal to the applicable limitations for taxable years beginning after 2021. Only one spouse may have deemed earned income under this rule.

**Child and dependent care tax credit in the U.S. territories**

General income tax rules for the 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. territories[98] 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 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.[99] 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.[100]

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

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

[97] Sec. 21(d)(2).

[98] The Code refers to the territories as "possessions."

[99] See secs. 931, 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.

[100] Sec. 937.

internal tax law of those territories (substituting the particular territory for the United States wherever the Code refers to the United States).[101] Thus, there is a mirror Code version of the child and dependent care 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.[102]

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.

The child and dependent care credit in the territories

With respect to taxable years beginning in 2021, the Secretary is directed to make payments to each of the mirror Code territories of 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.

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 application of section 21. This amount is determined by the Secretary based on information provided by the government of the territory.[103]

The Secretary is directed to pay to each of non-mirror Code territories of Puerto Rico and American Samoa amounts estimated by the Secretary as being equal to the aggregate benefits that would have been provided to the residents of the territory under section 21 if a mirror Code tax system had been in effect in the territory.[104] The Secretary is prohibited 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 for any person to whom a credit is allowed against territory income taxes as a result of the territory's mirror Code.[105] Similarly, no

[101] 48 U.SC. 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).

[102] Sec. 932 and former sec. 935.

[103] Sec. 21(h)(1).

[104] Sec. 21(h)(2).

[105] Sec. 21(h)(3).

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.

## Description of Proposal

The proposal makes permanent the provisions of the child and dependent care credit that only apply for taxable years beginning in 2021. Thus, the credit is fully refundable for taxpayers with a principal place of abode in the United States for more than one-half of the taxable year. The amount of the credit is 50 percent of employment-related expenses up to a limitation of $8,000 in the case of one qualifying individual and $16,000 if there are two or more qualifying individuals. The credit is subject to a two-part phaseout to the 50-percent credit rate. 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 adjusted gross income ("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.

The $8,000 and $16,000 limitations as well as the $125,000 phaseout threshold are adjusted for inflation for taxable years beginning after 2021.

The proposal also modifies the special rule for earned income in the case of a joint return, where one spouse is either (1) a full-time student or (2) 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 of the year. Under the proposal, for each month in which the student or incapacitated spouse qualifies, the spouse is deemed to have earned income equal to one-twelfth of $8,000 (adjusted for inflation) in the case of one qualifying individual or one-twelfth of $16,000 (adjusted for inflation) if there are two or more qualifying individuals.

Finally, the proposal makes permanent the payments by the Secretary to the territories to cover the cost of the territorial child and dependent care tax credit or analogous benefit.

## Effective Date

The proposal applies to taxable years beginning after December 31, 2021.

### 2. Increase in exclusion for employer-provided dependent care assistance made permanent

## Present Law

An annual exclusion[106] from the gross income of an employee is allowed for employer-provided dependent care assistance if such assistance is provided pursuant to a "dependent care assistance program." The amount of the exclusion was $5,000 ($2,500 in the case of a separate return by a married individual) through taxable years beginning in 2020. The ARPA temporarily increased the amount of the exclusion for employer-provided dependent care assistance for taxable years beginning in 2021 from $5,000 to $10,500 (and half of such amount

[106] Sec. 129(a).

in the case of a separate return by a married individual).[107] Amounts attributable to dependent care assistance that are excludible from gross income are also excludible from wages for employment tax purposes.[108]

Among other requirements, a dependent care assistance program[109] 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.[110]

A dependent care assistance program may be structured to allow contributions on a pre-tax basis through a cafeteria plan.[111] 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.[112] Qualified benefits provided under a cafeteria plan include dependent care assistance.

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.[113]

The ARPA provided that a plan that otherwise satisfied the requirements of a dependent care assistance program and cafeteria plan would not fail to meet those requirements if the plan was amended to reflect the increased temporary thresholds allowed pursuant to the bill and the amendment was retroactive if the following were 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.

## Description of Proposal

The proposal amends section 129(a)(2)(A) to make permanent the 2021 increase to the annual threshold from $5,000 to $10,500 (and half of such amount in the case of a separate return filed by married taxpayers). This amount will also be adjusted for inflation. For any

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[107] Pub. L. No. 117-2.

[108] Secs. 3401(b)(18), 3121(a)(18), 3306(b)(14).

[109] Sec. 129(d).

[110] 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 or such highly compensated employees or their dependents.

[111] Sec. 125.

[112] Sec. 125(d).

[113] 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).

taxable year beginning after December 31, 2021, the $10,500 amount in section 129(a)(2)(A) is increased by an amount equal to $10,500 multiplied by the cost-of-living adjustment determined for that taxable year.[114]

A plan that otherwise satisfies the requirements of a dependent care assistance program and cafeteria plan would not fail to meet those requirements if the plan was amended to reflect the proposal and the amendment was retroactive if the following were 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, 2021.

[114] Sec. 1(f)(3).

## C. Supporting Caregivers

### 1. Payroll tax credit for child care workers

**Present Law**

**Federal employment taxes**

Federal employment taxes are imposed on wages paid to employees with respect to employment and include taxes imposed under the Federal Insurance Contributions Act ("FICA"), the Federal Unemployment Tax Act ("FUTA"), and Federal income tax.[115] In addition, Tier 1 of the Railroad Retirement Tax Act ("RRTA") imposes a tax on compensation paid to railroad employees and representatives.[116]

FICA taxes are comprised of two components: the Old-Age, Survivors, and Disability Insurance ("OASDI") and Hospital Insurance ("Medicare").[117] With respect to Medicare taxes, the applicable rate is 2.9 percent with half of such rate (1.45 percent) imposed on the employee and the remainder (1.45 percent) imposed on the employer.[118] The employee portion of Medicare taxes must be withheld and remitted to the Federal government by the employer during the quarter, as required by the applicable deposit rules.[119] The employer is liable for the employee portion of Medicare taxes, in addition to its own share, whether or not the employer withholds the amount from the employee's wages.[120] OASDI and Medicare 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.[121]

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[115] Secs. 3101, 3111, 3301, and 3401.

[116] Sec. 3221.

[117] The Hospital Insurance tax includes two components: Medicare tax and Additional Medicare tax. Additional Medicare taxes are imposed on wages in excess of certain thresholds and are only imposed on the employee. Sec. 3101(b). There is no employer match for Additional Medicare tax. For purposes of this explanation, when referencing Medicare taxes, the term does not include Additional Medicare tax.

[118] Sec. 3101(b); 3111(b).

[119] Sec. 3102(a) and Treas. Reg. sec. 31.3121(a)-2. Sec. 6302.

[120] Sec. 3102(b).

[121] Secs. 201 and 1817 of the Social Security Act, Pub. L. No. 74-271 as amended (42 U.S.C. secs. 401 and 1395i). This section appropriates to the OASI and DI trust funds 100 percent of "the taxes imposed . . . by chapter 21 (other than sections 3101(b) and 3111(b)[*i.e.*, 3101(a) and 3111(a)]) of the Internal Revenue Code of 1954 with respect to wages (as defined in section 3121 of such Code)" "determined by the Secretary of the Treasury by applying the applicable rates of tax under such subchapter or chapter 21 (other than sections 3101(b) and 3111(b)) to such wages." Accordingly, the amount appropriated is based on the tax rate in effect on wages as defined in the statute. Similarly, section 1817 of the Social Security Act, 42 U.S.C. sec. 1395i, appropriates to the HI trust fund 100 percent of "the taxes imposed by sections 3101(b) and 3111(b) of the Internal Revenue Code of 1986 with respect to wages reported to the Secretary of the Treasury or his delegate pursuant to subtitle F of such Code after

Generally, the term "wages" for Medicare 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.[122] The name given to the remuneration for employment is immaterial. Medicare 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 FICA tax system. Compensation subject to RRTA tax is exempt from FICA taxes.[123] Instead, the railroad retirement system, while separate from and parallel to the Social Security Administration ("SSA"), is overseen by the SSA and the Railroad Retirement Board ("RRB"). The SSA collects taxes to fund the program, while the RRB is tasked with distributing benefits to eligible railroad industry employees and their family members to provide income assurance during retirement. These two governing bodies cooperate in determining an individual's benefits.

RRTA tax rates

The RRTA imposes a tax on compensation paid by covered employers to employees in recognition for the performance of services.[124] Employees whose compensation is subject to RRTA are ultimately eligible for railroad retirement benefits that fall under a two-tier structure. Rail employees and employers pay tier 1 taxes at the same rate as other employment taxes.[125] In addition, rail employees and employers both pay tier 2 taxes which are used to finance railroad retirement benefits over and above social security benefit levels.[126] Tier 2 benefits are similar to a private defined benefit pension. Those taxes are funneled to the railroad retirement system and used to fund basic retirement benefits for railroad workers and an investment trust that generates returns for the pension fund.

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December 31, 1965, as determined by the Secretary of the Treasury by applying the applicable rates of tax under such sections to such wages."

[122] Sec. 3121(a).

[123] Sec. 3121(b)(9).

[124] Secs. 3201 through 3233. Instead of FICA taxes, railroad employers and employees are subject, under the RRTA, to taxes equivalent to the Social Security and Medicare 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.

[125] 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.

[126] 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 and income tax in the U.S. territories**

FICA tax

Employers and employees in the U.S. territories are generally subject to FICA payroll tax obligations.[127] 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.[128] 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.

Income tax

Citizens of the United States are generally subject to Federal income tax on their worldwide income, including those citizens in the U.S. territories. Residents of the U.S. territories are generally subject to the Federal income tax system based on their status as U.S. citizens or residents in the territories, with certain special rules for determining residence and source of income specific to the territory. Broadly, a bona fide 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.[129]

The application of the Federal income 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). 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. American Samoa and Puerto Rico, by contrast, are referred to as non-mirror Code territories that have their own internal tax laws. A resident of either American Samoa or Puerto Rico may be required to file income tax returns with both the territory of residence and the United States.

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[127] 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.

[128] Under section 3401(a)(8), most wages paid to U.S. persons for services performed in one of the territories are excluded from withholding of Federal income tax 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.

[129] See secs. 931, 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.

Payroll tax credits

Under present law, there is no tax credit against FICA taxes for child care wages. Recently enacted credits against OASDI or Medicare taxes include paid sick or expanded family and medical leave,[130] employee retention,[131] and COBRA premium assistance.[132]

## Description of Proposal

An eligible child care employer is allowed a refundable credit against the applicable employment taxes imposed on the employer for each calendar quarter in an amount equal to 50 percent of the qualified child care wages paid with respect to each eligible employee of such employer for such calendar quarter. The amount of qualified child care wages for an eligible employer which may be taken into account for any calendar quarter shall not exceed $2,500. An eligible child care employer may elect (at such time and in such manner as the Secretary may prescribe) not to take certain qualified wages into account. In addition, no credit is allowed for the United States Government or to an agency or instrumentality thereof, except any section 501(c)(3) organization exempt from tax under section 501(a).

The credit is applied against an eligible employer's applicable employment taxes, which includes the employer's share of Medicare taxes and the equivalent amount of RRTA taxes imposed on railroad employers.[133] The term wages includes amounts paid or incurred by the eligible child care employer to provide and maintain a group health plan,[134] but only to the extent such amounts are excluded from the employees' income as coverage under an accident or health plan.[135] Qualified health plan expenses are allocated to child care wages in such manner as the Secretary of Treasury (or the Secretary's delegate) may prescribe. Except as otherwise provided

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[130] Pub. L. No. 116-127; Secs. 3131, 3132. The expiration of the credits was extended by the Taxpayer Certainty and Disaster Relief Act of 2020, to March 30, 2021. Pub. L. No. 116-260. The ARPA allowed certain employers to claim refundable tax credits for the cost of providing paid sick and expanded family and medical leave to employees to receive or recover from vaccination for COVID-19. The ARPA extension and expansion of the tax credits were for paid sick and expanded family and medical leave from April 1, 2021 through September 30, 2021. Sec. 3131; 3132.

[131] Pub. L. No. 117-136. The Taxpayer Certainty and Disaster Relief Act of 2020 amended and extended the employee retention credit to June 30, 2021, and the ARPA added section 3134 to amend and extend the employee retention credit to December 31, 2021.

[132] Pub. L. No. 117-2; sec. 6432. The ARPA provided a credit against the employer's share of Medicare tax, or the equivalent amount of RRTA tax, in an amount equal to COBRA premiums payable for continuation coverage not paid by assistance eligible individuals.

[133] Secs. 3111(b); 3221(a). The term "wages" means wages, as defined in section 3121(a) for FICA purposes without regards to the exclusions enumerated in paragraphs (1) through (22) of section 3121(b), and compensation, as defined in section 3231(e) without regards to any exclusions from the term enumerated in paragraph (1). Any credit allowed under this proposal shall be treated as a credit of the customer of the certified professional employer organization as described in section 3511(d)(2).

[134] Sec. 5000(b)(1).

[135] Sec. 106(a).

by the Secretary, such allocations are treated as properly made under the proposal if made on the basis of being pro rata on the basis of periods of coverage.

An eligible child care employer is any employer that operates one or more qualified child care facilities.[136] A qualified child care facility for purposes of this proposal is any facility which is certified as an "HHS Participating Child Care Provider" by the Secretary of Health and Human Services under section 418A(c) of the Social Security Act. The proposal has an aggregation rule requiring persons to be treated as a single employer to the extent subsection (a) or (b) of section 52, or subsection (m) or (o) of section 414, apply for purposes of this section.

An eligible employee is any employee of an eligible child care employer for any calendar quarter who meets two criteria: (1) the aggregate wages paid to the employee in the quarter may not exceed 25 percent of the dollar amount in effect for the quarter for highly-compensated employees ($130,000 annually in 2021),[137] and (2) the aggregate wages paid to such employee for the one-year period ending with the close of such quarter do not exceed 100 percent of such dollar amount.

Child care wages are wages paid for the employee's services to provide child care at a qualified child care facility or to provide support services for such a facility.[138] The qualified child care wages taken into account for this credit are the child care wages paid by the child care employer in excess of the applicable minimum rate. Applicable minimum rate means the rate of basic pay which is payable for GS-3, step 1, of the General Schedule,[139] at the time the wages are paid and determined based on the locality in which the services are provided. Qualified child care wages does not include any wages paid by an eligible child care employer during a period where the employer does not have the HHS certification, described above.

Qualified child care wages paid by an eligible child care employer cannot include the following taken into account as payroll costs in connection with: (1) a covered loan under section 7(a)(37) or 7A of the Small Business Act; (2) a grant under section 324 of the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act, or (3) a restaurant revitalization grant under section 5003 of the ARPA. The Secretary is directed to issue guidance providing that payroll costs paid during the covered period may be included in qualified child care wages to the extent that: (1) a covered loan under section 7(a)(37) of the Small Business Act is not forgiven by reason of a decision under section 7(a)(37)(J) of such Act; or (2) a covered loan of the taxpayer under section 7A of the Small Business Act is not forgiven by reason of a decision under section 7A(g) of such Act.

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[136] All persons treated as a single employer under subsection (a) or (b) of section 52, or subsection (m) or (o) of section 414, shall be treated as one employer for purposes of this proposal.

[137] Sec. 414(q)(1)(B)(i).

[138] Child care wages does not include wages taken into account under sections 41, 45A, 45P, 45R, 51, 1396, 3131, 3132, 3134, or 6432.

[139] Subchapter III, Chapter 53, Title 5, United States Code.

The proposal provides that the credit allowed may not exceed the tax imposed on the employer, reduced by certain other payroll tax credits[140] 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 applicable employment taxes imposed on the employer, reduced as described in the prior sentence, such excess is treated as a refundable overpayment.[141] The credit may be advanced according to forms and instructions provided by the Secretary.

The proposal also includes a denial of double benefit rule. The gross income of the employer, for the taxable year which includes the last day of the quarter with respect to which a credit is allowed under this proposal, shall be increased by the amount of such credit for purposes of the income tax under Chapter 1.

The Secretary will prescribe regulations or other guidance to prevent avoidance of the purposes of this proposal, to minimize compliance and record-keeping burdens under this proposal, providing for a waiver of penalties for failure to deposit amounts in anticipation of the allowance of the credit allowed under the proposal, for recapturing the benefit of credits determined under this proposed in cases where a subsequent adjustment to the credit is determined, to permit advancement of the credit, and for determining qualified child care wages of eligible employees not paid at a single rate of pay.

**Effective Date**

The amendments made by this proposal shall apply to calendar quarters beginning after December 31, 2021.

**2. Credit for caregiver expenses**

**Present Law**

**Child and dependent care tax credit**

A taxpayer with one or more qualifying individuals is allowed a credit against income tax liability for employment-related expenses for child and dependent care.[142] For this purpose, employment-related expenses are expenses for household services and expenses for the care of a qualifying individual.[143] These expenses must be incurred to enable the taxpayer to be gainfully

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[140] Applicable employment taxes for this purpose are reduced by any credits allowed under sections 3131, 3132, 3134, and 6432.

[141] 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. sec. 1324. Thus, amounts are appropriated to the Secretary of the Treasury for refunding such excess amounts.

[142] Sec. 21.

[143] Sec. 21(b)(2). Expenses do not include amounts paid for a camp where a qualifying individual stays overnight. Household services are the performance in and about the taxpayer's home of ordinary and usual services

employed during any period for which there are one or more qualifying individuals with respect to the taxpayer.

A qualifying individual is, in general: (1) a dependent[144] of the taxpayer 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.[145]

Employment-related expenses taken into account in determining the credit generally may not exceed a taxpayer's earned income.[146] In the case of a joint return, expenses taken into account generally may not exceed the earned income of the spouse with the lower earned income.[147] The amount of employment-related expenses that may be taken into account is reduced by any amount excluded from income under an employer-provided dependent care assistance program under section 129.[148]

The maximum allowable credit for a taxable year beginning in 2021 is 50 percent of employment-related expenses up to $8,000 for a taxpayer with one qualifying individual and $16,000 for a taxpayer with two or more qualifying individuals.[149] The maximum credit is therefore $4,000 if there is one qualifying individual and $8,000 if there are two or more qualifying individuals.

The credit for 2021 is subject to a two-part income-based phaseout.[150] The 50-percent credit rate is reduced, but not below 20 percent, by one percentage point for each $2,000 (or fraction thereof) of adjusted gross income ("AGI") above $125,000. 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.

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necessary to the maintenance of the household and attributable to the care of the qualifying individual. Treas. Reg. sec. 1.21-1(d)(3).

[144] See sec. 152 for the definition of dependent.

[145] Sec. 21(b)(1).

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

[147] Special rules apply to married couples in cases where one spouse is either a full-time student or physically or mentally incapable of caring for himself or herself. Sec. 21(d)(2). In these cases, the student or incapacitated spouse is deemed to be employed and deemed to have earned income of no less than $250 (if the household has one qualifying individual) or $500 (if the household has two or more qualifying individuals).

[148] Sec. 21(c).

[149] Sec. 21(g)(2), (3).

[150] Sec. 21(g)(4).

The credit is refundable in 2021 for a taxpayer who has a principal place of abode in the United States for more than one half of the taxable year.[151] 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 the rules for the earned income tax credit.[152] A taxpayer who otherwise is allowed the child and dependent care credit but does not satisfy the principal place of abode is allowed a nonrefundable credit.

For taxable years beginning after 2021, the maximum allowable credit is 35 percent of employment-related expenses up to $3,000 for a taxpayer with one qualifying individual, and $6,000 for a taxpayer with two or more qualifying individuals.[153] The maximum credit is, therefore, $1,050 in respect of one qualifying individual and $2,100 in respect of two or more qualifying individuals. 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.[154] For a taxpayer with AGI above $43,000 the credit rate is, therefore, 20 percent, and the maximum credit is $600 for one qualifying individual and $1,200 for two or more qualifying individuals. The credit is nonrefundable in taxable years beginning after 2021.

For taxpayers in the U.S. territories, special rules apply.

**Exclusions and deductions for dependent care and medical expenses**

For 2021 an employee generally is allowed to exclude from gross income up to $10,000 ($5,000 for a married individual filing a separate return) for amounts paid or incurred by the employer for dependent care assistance to the employee under a dependent care assistance program.[155]

An individual generally is allowed an itemized deduction for expenses, not compensated by insurance or otherwise, paid for medical care of the individual, the individual's spouse, or a dependent to the extent that the expenses exceed 7.5 percent of adjusted gross income.[156]

An individual who is covered under a high deductible health plan and who satisfies certain other requirements generally is allowed an itemized deduction for a limited amount paid in cash by or on behalf of the individual to the individual's health savings account.157 For an

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[151] Sec. 21(g)(1).

[152] See sec. 32(c)(3)(C).

[153] Sec. 21(c).

[154] Sec. 21(a).

[155] Sec. 129. The child and dependent care tax credit is not allowed (and no other deduction or credit is allowed) for amounts excluded under section 129. See sec. 129(e)(7).

[156] Sec. 213. This deduction is not allowed for any expense for which the child and dependent care tax credit is allowed. Sec. 213(e).

[157] Sec. 223.

individual with family coverage, the maximum amount of the deduction in 2021 is $7,200. For an individual with self-only coverage, the maximum deduction in 2021 is $3,600. Distributions from health savings accounts used to pay qualified medical expenses are not includible in gross income.

## Description of Proposal

### In general

The proposal provides a nonrefundable credit against income tax (the "caregiver credit") for an individual for whom there is at least one qualified care recipient. The credit generally equals 50 percent of the amount that the individual pays or incurs in a taxable year (and for which the individual is not compensated by insurance or otherwise) for qualified expenses of up to $4,000. This 50-percent credit rate is reduced by 1 percentage point for every $2,500 or fraction thereof by which the individual's adjusted gross income exceeds $75,000.

### Qualified care recipient

For purposes of the caregiver credit, an individual is a qualified care recipient for a taxable year with respect to the person claiming the credit if the individual (1) is the spouse of the person claiming the credit or bears to the person claiming the credit any one of the relationships described in subparagraphs (A) through (H) of section 152(d)(2); (2) has been certified before the tax return filing due date for the taxable year (but within the 18-month period ending on that due date (or another period prescribed by the Secretary)) by a licensed health practitioner (as defined in section 7702B(c)(4)) as being an individual with certain long-term care needs (described below) for a period that is expected to be at least 180 consecutive days and a portion of which occurs within the taxable year; and (3) resides in a personal residence, not an institutional care facility.

An individual is considered to have long-term care needs if the individual satisfies any one of several age-based requirements. An individual who is at least six years of age has long-term care needs if the individual (1) is unable to perform without substantial assistance from another individual at least two activities of daily living (defined in section 7702B(c)(2)(B)) due to a loss of functional capacity, or (2) requires substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment and (a) is unable to perform without reminding or cuing assistance at least one activity of daily living (defined in section 7702B(c)(2)(B)), or (b) to the extent provided in regulations prescribed by the Secretary (in consultation with the Secretary of Health and Human Services), is unable to engage in age appropriate activities. An individual who is at least two but not six years of age is considered to have long-term care needs if the individual is unable, due to a loss of functional capacity, to perform without substantial assistance from another individual at least two of the following activities: eating, transferring, and mobility. An individual who is under the age of two is considered to have long-term care needs if the individual requires specific durable medical equipment by reason of a severe health condition or requires a skilled practitioner trained to address the individual's condition to be available if the individual's parents or guardians are absent.

An institutional care facility (including two or more places, establishments, or institutions owned by the same legal entity) includes any congregate, protected living residential arrangement that provides or coordinates personal or health care services, including assistance with the activities of daily living and social care, for two or more adults who are aged, infirm, or disabled.

**Qualified expenses**

Qualified expenses for which the caregiver credit is allowed are expenses for certain goods, services, and supports that assist a qualified care recipient with accomplishing activities of daily living (as defined in section 7702B(c)(2)(B)) and instrumental activities of daily living (as defined in section 1915(k)(6)(F) of the Social Security Act) and that are provided solely for use by the qualified care recipient. The goods, services, and supports for which qualified care expenses may be paid are human assistance, supervision, cuing, and standby assistance; health maintenance tasks (such as medication management); respite care; assistive technologies and devices (including remote health monitoring); accessibility modifications of the qualified care recipient's residence; counseling, support groups, or training related to caring for a qualified care recipient; and any other items that directly relate to the health and safety of a qualified care recipient, as determined by the Treasury Secretary after consultation with the Secretary of Health and Human Services.

An amount may not be taken into account as a qualified expense if it is taken into account for purposes of the child and dependent care tax credit, the exclusion for amounts paid to employees under dependent care assistance programs, the itemized deduction for medical expenses that exceed 7.5 percent of adjusted gross income, or as an amount for which an exclusion from gross income is allowed for a distribution from a health savings account.

An individual may treat an amount as a qualified expense only if the individual substantiates the expense under regulations or other guidance prescribed by the Secretary.

**Special rules**

Under rules similar to those for the child and dependent care tax credit, no credit is allowed for expenses paid to certain related individuals.[158]

The licensed health care practitioner making the certification of long-term care needs must satisfy the following requirements. The individual may not be related (within the meaning of section 51(i)(1)) to, or have a conflict of interest (under regulations prescribed by the Secretary) with respect to, the individual claiming the credit or the qualified care recipient. The individual must be licensed and eligible under applicable State law to certify limitations in performing activities of daily living. The individual must be a participant in either the Medicaid program (under sections 1902(a)(77) and 1932(d)(6) of the Social Security Act) or the State Children's Health Insurance Program (under Social Security Act section 2107(e)(1)(G)).

[158] See sec. 21(e)(6).

An individual is allowed the caregiver credit with respect to a qualified care recipient only if the individual includes on the tax return the name and specified provider identification number of the licensed health care practitioner who makes the long-term care certification. A specified provider identification number is a valid National Provider Identifier as authorized under Social Security Act section 1173. Similarly, an individual is allowed the caregiver credit with respect to a qualified care recipient only if the individual includes on the tax return the taxpayer identification number of that recipient. The omission of a correct specified provider identification number or a correct taxpayer identification number is an error for which the proposal gives the IRS math error authority.[159]

An individual may be treated as a qualified care recipient with respect to only one taxpayer for a taxable year.

**Termination**

The caregiver credit is not allowed for any taxable year beginning after December 31, 2025.

## Effective Date

The proposal applies to taxable years beginning after December 31, 2021.

[159] See sec. 6213(g)(2).

## D. Certain Improvements to the Earned Income Tax Credit Made Permanent and Funds for Administration of Earned Income Tax Credits in the Possessions

### 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.[160]

The EITC generally equals a specified percentage of earned income.[161] 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.[162]

For an individual to be a qualifying child for purposes of the EITC, generally that individual must meet the relationship, age, and residency tests under section 152.[163]

The EITC may be claimed by a taxpayer if the taxpayer is a U.S. citizen or a resident alien.[164] 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

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[160] Sec. 32.

[161] Sec. 32(a), (b).

[162] Sec. 32(b). All income thresholds are indexed for inflation annually.

[163] 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.

[164] Sec. 32(c)(1)(D).

exclusion election available to U.S. citizens or resident aliens living abroad) are not eligible to claim the EITC.[165]

A taxpayer with certain investment income in excess of $10,000 for the taxable year may not claim the EITC.[166]

The earned income amount, beginning of the phaseout range, and $10,000 investment income thresholds are adjusted for inflation.[167]

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 valid SSN) on his or her tax return.[168] 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.[169]

**Credit Structure for EITC for taxpayers with no qualifying children**

For taxable years beginning in 2021

A taxpayer with no qualifying children may claim a credit if the taxpayer satisfies the age requirements (discussed below), 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.[170] 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.[171]

ARPA expanded the EITC for taxpayer with no qualifying children for one year. For taxable years beginning in 2021, the credit is 15.3 percent of earned income up to an earned income amount of $9,820, resulting in a maximum credit of $1,502.[172] The maximum credit is available for a taxpayer with earned income between $9,820 and $11,610 ($17,560 if married filing jointly). The credit begins to phaseout out at a rate of 15.3 percent of earned income or

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[165] Sec. 32(c)(1)(C).

[166] Sec. 32(i).

[167] Sec. 32(j).

[168] Sec. 32(c)(1)(E), (c)(3)(D), (m).

[169] 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.

[170] Sec. 32(c)(1)(A)(ii).

[171] Sec. 32(c)(4).

[172] Sec. 32(n)(3), (4).

AGI above $11,610 ($17,560 if married filing jointly), resulting in a $0 credit at $21,430 of earned income or AGI ($27,380 if married filing jointly).[173]

For taxable years beginning after 2021

For taxable years beginning in 2022, the credit is 7.65 percent of earned income up to an earned income amount of $7,200, resulting in a maximum credit of $551.[174] The maximum credit is available for a taxpayer with earned income between $7,200 and $9,010 ($15,050 if married filing jointly). The credit begins to phase out at a rate of 7.65 percent of earned income or AGI above $9,010 ($15,050 if married filing jointly) resulting in a $0 credit at $16,210 of earned income or AGI ($22,250 if married filing jointly).

For taxable years beginning after 2022, these amounts are adjusted for inflation.

**Age Requirements for EITC for taxpayers with no qualifying children**

For taxable years beginning in 2021

For taxable years beginning in 2021, the minimum age for taxpayer's claiming the EITC for taxpayers with no qualifying children is generally 19.[175] 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 24.[176] 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, 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 minimum age is 18 for any qualified former foster youth or qualified homeless youth.[177] 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 B[178] or part E[179] of Title IV of the Social Security Act.

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[173] Rev. Proc. 2021-23.

[174] See sec. 32(b), (j).

[175] Sec. 32(n)(1)(A), (B)(i).

[176] Sec. 32(n)(1)(A), (B)(ii). The Secretary is required 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).

[177] Sec. 32(n)(1)(B)(iii), (D), (C).

[178] 42 U.S.C. secs. 621-628b.

[179] 42 U.S.C. secs. 670-679c.

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.[180] A qualified homeless youth must give the 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.

For taxable years beginning in 2021, there is no upper age limit on the credit for taxpayers with no qualifying children.[181] Therefore, taxpayers 65 and older without qualifying children may claim the credit in 2021.

For taxable years beginning after 2021

A taxpayer with no qualifying children may claim the EITC if the taxpayer is age 25 or older and below age 65.

**Earned income lookback**

For taxable years beginning in 2021, a taxpayer may elect to calculate the taxpayer's EITC using 2019 rather than 2021 earned income, if the taxpayer's earned income in 2021 is less than in 2019.[182]

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.

**EITC in the territories**

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 Secretary is required to pay to Puerto Rico each calendar year, starting in 2021, a specified matching amount of the cost of its EITC.[183] For each calendar year 2021 through 2025, the Secretary is also required to pay to Puerto Rico the lesser of (1) Puerto Rico's

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[180] 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.

[181] Proposed sec. 32(n)(2).

[182] ARPA, Pub. L. No. 117-2, sec. 9626.

[183] Sec. 7530(a).

expenditures for education efforts with respect to taxpayers and tax return preparers regarding the EITC, or (2) $1 million.

The Secretary is required to make payments to Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands each calendar year starting in 2021 equal to the cost to that territory of its EITC in the year.[184] For each calendar year 2021 through 2025, the Secretary is also required 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 is required 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.[185] The amount of the annual payment is the lesser of (1) the cost to American Samoa of such credit each year, or (2) $16 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 determination of the cost of the EITC to each territory is determined without taking into account administrative costs.

## Description of Proposal

### EITC for taxpayers with no qualifying children

The proposal makes permanent the credit structure for the EITC for taxpayers with no qualifying children that currently applies only to taxable years beginning in 2021. Thus, it makes permanent the 15.3 percent credit percentage and increased earned income amounts and beginning amounts of the phaseout range.

The proposal also makes permanent the changes to the minimum and maximum age for the EITC for taxpayers with no qualifying children that currently apply only to taxable years beginning in 2021.

### Earned income lookback

Under the proposal, a taxpayer may elect to calculate the taxpayer's EITC using preceding taxable year rather than current taxable year earned income, if the taxpayer's earned income in the preceding year is less than in the current year.

[184] Sec. 7530(b).

[185] Sec. 7530(c).

In the case of a joint return, the earned income which is attributable to the taxpayer for the preceding year is the sum of the earned income which is attributable to each spouse for the preceding year.

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.

**EITC in the territories**

Under the proposal, for each calendar year beginning in 2021, Puerto Rico is provided up to $4,000,000 to pay for the reasonable administrative costs of implementing its EITC.[186]

Under the proposal, for each calendar year beginning in 2021, the mirror Code territories are provided up to $200,000 to pay for the reasonable administrative costs of implementing their EITCs.

Under the proposal, for each calendar year beginning in 2021, American Samoa is provided up to $200,000 to pay for the reasonable administrative costs of implementing its EITC.[187]

## Effective Date

The proposal generally applies to taxable years beginning after December 31, 2021.

The proposal with respect to the EITC in the territories is effective on the date of enactment for payments made for calendar years beginning after December 31, 2021.

[186] This payment is only required for years in which the Secretary, because Puerto Rico has enacted changes to its EITC designed to substantially increase workforce participation, is required to make payments to Puerto Rico to cover a portion of the cost of its EITC

[187] This payment is only required for years in which the Secretary, because American Samoa has enacted an EITC designed to substantially increase workforce participation, is required to make payments to American Samoa to cover the cost of its EITC.

## E. Expanding Access to Health Coverage and Lowering Costs

### 1. Improve affordability and reduce premium costs of health insurance for consumers and other provisions to modify 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,"[188] health insurance plans offered through an American Health Benefit Exchange ("Exchange") created by the Patient Protection and Affordable Care Act ("PPACA").[189] 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.[190] 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.[191] For taxable years beginning in 2021 and 2022, eligibility for the premium assistance credit was expanded to individuals with household incomes above 400 percent of FPL.[192]

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).[193] Modified AGI is defined as AGI increased by (1) any amount excluded from

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[188] 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.

[189] 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").

[190] Sec. 1412 of the PPACA, 42 U.S.C sec. 18082.

[191] 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.

[192] Sec. 36B(c)(1)(E). This temporary expansion was enacted in ARPA, sec. 9661.

[193] Sec. 36B(d)(2).

gross income for citizens or residents living abroad,[194] (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.[195] To be eligible for the premium assistance credit, individuals who are married must file a joint return.[196] 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.[197] 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.[198] 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)[199] of the employee's household income. 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.

**Qualified small employer health reimbursement arrangements**

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.[200] 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).

**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

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[194] Sec. 911.

[195] Under section 86, only a portion of an individual's Social Security benefits is included in gross income.

[196] Sec. 36B(c)(1)(C).

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

[198] Sec. 36B(c)(2)(C).

[199] Rev. Proc. 2020-36, 2020-32 I.R.B. 244.

[200] Sec. 36B(c)(4)(C).

second lowest cost silver plan in the rating area where the individual resides,[201] reduced by the individual's or family's share of premiums.[202] As shown in Table 1 below, an individual's or a family's share of premiums is a certain percentage of household income. The percentage is indexed annually to the rate of premium growth over income growth for the preceding calendar year.

Prior to amendment by ARPA, for 2021, the share of premiums was 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.[203] However ARPA reduced or eliminated the individual's or family's share of premiums used in determining the amount of the premium assistance credit for taxable years beginning in 2021 and 2022. ARPA also extended eligibility to individuals and families with household income above 400 percent of FPL. Table 1 below shows an individual's or family's modified share of premiums applicable for 2021 and 2022 under ARPA. The share of premiums ranges 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. The share of premiums is not indexed for 2022 under ARPA.

**Table 1.−Household's Share of Premiums (for 2021)**

| Household income (expressed as a percent of FPL) | Prior to ARPA | | Under ARPA | |
|---|---|---|---|---|
| | Initial percentage of household income* | Final percentage of household income* | Initial percentage of household income* | Final percentage of household income* |
| Less than 133% | 2.07 | 2.07 | 0.0 | 0.0 |

[201] 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.

[202] 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.

[203] 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.

| Household income (expressed as a percent of FPL) | Prior to ARPA | | Under ARPA | |
|---|---|---|---|---|
| | Initial percentage of household income* | Final percentage of household income* | Initial percentage of household income* | Final percentage of household income* |
| 133% up to 150% | 3.10 | 4.14 | 0.0 | 0.0 |
| 150% up to 200% | 4.14 | 6.52 | 0.0 | 2.0 |
| 200% up to 250% | 6.52 | 8.33 | 2.0 | 4.0 |
| 250% up to 300% | 8.33 | 9.83 | 4.0 | 6.0 |
| 300% up to and including 400% | 9.83 | 9.83 | 6.0 | 8.5 |
| 400% and higher | not eligible | not eligible | 8.5 | 8.5 |

* 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").[204] The individual must provide information on income, family size, changes in marital or family status or income, and citizenship or lawful presence status.[205] 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.[206] If an

[204] 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.

[205] 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.

[206] 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 though 1397mm, and a Basic Health Program under section 1331 of PPACA, 42 U.S.C. sec. 18051.

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.[207]

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.[208] For an individual with household income below 400 percent of FPL, recapture for a taxable year generally 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.

**Table 2.−Recapture Limits (for 2021)[209]**

| 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 |

[207] 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.

[208] For a taxable year beginning in 2020, ARPA temporarily removed 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, for 2020, no excess advance payment was subject to recapture. Sec. 36B(f)(2)(B)(iii).

[209] 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.

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.

**Employer shared responsibility payment**

An applicable large employer, as defined below, may be subject to a tax, called an "assessable payment," for a month if one or more of its full-time employees is certified to the employer as receiving for the month a premium assistance credit with respect to health insurance purchased through an Exchange (commonly referred to as the "employer mandate").[210] As discussed below, the amount of the assessable payment depends on whether the employer offers its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under a group health plan sponsored by the employer and, if it does, whether the coverage offered is affordable and provides minimum value.

Definitions of full-time employee and applicable large employer

An applicable large employer generally means, with respect to a calendar year, an employer who employed an average of at least 50 full-time employees on business days during the preceding calendar year. For purposes of these rules, full-time employee means, with respect to any month, an employee who is employed on average at least 30 hours of service per week. Solely for purposes of determining whether an employer is an applicable large employer (that is, whether the employer has at least 50 full-time employees), besides the number of full-time employees, the employer must include the number of its full-time equivalent employees for a month, determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120. In addition, in determining whether an employer is an applicable large employer, members of the same controlled group, group under common control, and affiliated service group are treated as a single employer.[211] If the group is an applicable large employer under this test, each member of the group is an applicable large employer even if any member by itself would not be an applicable large employer.

Assessable payments

If an applicable large employer does not offer coverage or offers coverage to less than 95 percent of its full-time employees and their dependents under an employer-sponsored plan and at least one full-time employee is so certified to the employer, the employer may be subject to an assessable payment (for 2021) of $2,700 (divided by 12 and applied on a monthly basis) multiplied by the number of its full-time employees in excess of 30, regardless of the number of full-time employees so certified.

Generally, an employee who is offered minimum essential coverage under an employer-sponsored plan is not eligible for a premium assistance credit or reduced cost-sharing

[210] Sec. 4980H.

[211] The rules for determining controlled group, group under common control, and affiliated service group under section 414(b), (c), (m), and (o) apply for this purpose.

unless the coverage is unaffordable or fails to provide minimum value. However, if an employer offers coverage to at least 95 percent of its full-time employees and their dependents under an employer-sponsored plan and at least one full-time employee is certified as receiving a premium assistance credit or reduced cost-sharing (because the coverage is unaffordable or fails to provide minimum value), the employer may be subject to an assessable payment (for 2021) of $4,060 (divided by 12 and applied on a monthly basis) multiplied by the number of such full-time employees. However, the assessable payment in this case is capped at the amount that would apply if the employer failed to offer its full-time employees and their dependents minimum essential coverage.

**Income taxation of Social Security benefits**

Section 86 provides rules for determining what amount, if any, of a taxpayer's Social Security benefits are includible in gross income. Social Security benefits that are not taxed under section 86 are excluded from gross income. For purposes of section 86, Social Security benefits generally include monthly retirement benefits payable under title II of the Social Security Act and tier 1 Railroad Retirement benefits.[212]

Portion of Social Security benefits includible in gross income

The amount of Social Security benefits includible in gross income is determined under a two-tier system. Taxpayers receiving Social Security benefits are not required to include any portion of such benefits in gross income if their provisional income does not exceed a first-tier threshold, which is $25,000, in the case of unmarried individuals, or $32,000, in the case of married individuals filing jointly.[213] A second-tier threshold for provisional income is $34,000, in the case of unmarried individuals, or $44,000, in the case of married individuals filing joint returns.[214] These thresholds are not indexed for inflation.

If the taxpayer's provisional income exceeds the first-tier threshold but does not exceed the second-tier threshold, then the amount required to be included in gross income is the lesser of: (1) 50 percent of the taxpayer's Social Security benefits, or (2) 50 percent of the excess of the taxpayer's provisional income over the first-tier threshold.

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[212] If a taxpayer's Social Security benefits or Railroad Retirement benefits are offset by worker's compensation benefits, then the amount of the taxpayer's Social Security benefits is increased by the amount of such offset.

[213] In the case of a married individual who files a separate return, the first-tier threshold is generally zero. However, if the individual lives apart from his or her spouse for the entire year, the first-tier threshold is $25,000.

For purposes of these computations, a taxpayer's provisional income is defined as AGI increased by certain amounts, including, generally: (1) tax-exempt interest; (2) excludable interest on educational savings bonds; (3) adoption assistance payments; (4) certain deductible student loan interest; (5) certain excludable foreign-source earned income; (6) certain U.S. possession income; and (7) one-half of the taxpayer's Social Security benefits.

[214] In the case of a married individual who files a separate return, the second-tier threshold is generally zero. However, if the individual lives apart from his or her spouse for the entire year, the second-tier threshold is $34,000.

If the amount of provisional income exceeds the second-tier threshold, then the amount required to be included in gross income is the lesser of: (1) 85 percent of the taxpayer's Social Security benefits; or (2) the sum of (a) 85 percent of the excess of the taxpayer's provisional income over the second-tier threshold, plus (b) the smaller of (i) the amount of benefits that would have been included in income if the 50-percent inclusion rule (described in the previous paragraph) were applied, or (ii) one-half of the difference between the taxpayer's second-tier threshold and first-tier threshold.[215]

Treatment of lump-sum payment of Social Security benefits

In the event of a lump-sum payment of Social Security benefits received during the taxable year that are attributable in any part to prior years, an individual may make an election to compute the taxable amount of the payment of benefits as if the benefits had been received in the prior taxable years to which they are attributable. A Social Security benefit may be attributed to a particular taxable year if the generally applicable payment date for such benefit occurred during the taxable year. If the election is made, the taxpayer will determine the tax for the taxable year of receipt of the lump-sum payment by including in gross income for the current year the sum of the increases in gross income that result solely from taking into account the appropriate portions of the lump-sum payment in the taxable year to which they are attributable.

**Unemployment compensation**

Unemployment compensation benefits are includible in gross income.[216] 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.[217]

ARPA provided a temporary special rule in the case of a taxpayer who has received, or has been approved to receive, unemployment compensation (as defined in section 85(b)) for any week during calendar year 2021.[218] 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 provision, 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 by subject to lower recapture than under present law. In addition, a taxpayer receiving unemployment compensation during 2021 whose household income is less

[215] Special rules apply in some cases. In the case of nonresident individuals who are not U.S. citizens, 85 percent of Social Security benefits are includible in gross income and subject to the 30-percent withholding tax (sec. 871(a)(3)). The taxation of Social Security benefits may also be specified in income tax treaties between the United States and other countries.

[216] Sec. 85.

[217] Sec. 85(b); see also Treas. Reg. sec. 1.85-1(b)(1).

[218] Sec. 36B(g).

than 100 percent of FPL for a family of the size involved may be allowed a premium assistance credit.

## Description of Proposal

### Improve affordability and reduce premium costs of health insurance for consumers

The proposal makes permanent the reduction in ARPA of the share of premiums that individuals or households must contribute towards the cost of health insurance in calculating the amount of their premium assistance credit. The proposal also makes permanent the expansion in ARPA of eligibility for the premium assistance credit to individuals and families with household incomes above 400 percent of FPL for a family of the size involved, provided the other eligibility criteria are met. The proposal permanently repeals indexing of the individual or household's share of premiums used in determining the premium assistance credit.

### Modification of employer-sponsored coverage affordability test in health insurance premium tax credit

The proposal lowers the affordability percentage for employer-sponsored plans from 9.83 percent (for 2021) to 8.5 percent. Accordingly, 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 employee's share of the premium for self-only coverage under the plan exceeds 8.5 percent or does not provide minimum value, and (2) the individual declines the employer-offered coverage.

The proposal also lowers the affordability percentage for QSEHRAs from 9.83 percent (for 2021) to 8.5 percent.

Under the proposal, the 8.5 percent affordability percentages for employer-sponsored plans and QSEHRAs are not indexed for inflation.

### Treatment of lump-sum Social Security benefits in determining household income

For purposes of determining household income with respect to the premium assistance credit, the proposal excludes from the definition of modified AGI any portion of a lump-sum payment of Social Security benefits received during the taxable year that is attributable to months ending before the beginning of the taxable year. A lump-sum payment of Social Security benefits means any payment of Social Security benefits which constitutes more than one month of benefits. For any taxable year beginning after the termination date described below, a taxpayer may elect to not exclude the portion of a lump-sum payment of Social Security benefits allowed to be excluded under the proposal.

The proposal applies with respect to the amount of Social Security benefits includible in gross income and the amount of Social Security benefits not includible in gross income (but included in modified AGI for purposes of the premium assistance credit).

**Temporary expansion of health insurance premium tax credits for certain low-income populations**

The proposal provides temporary rules for the premium assistance credit to certain low-income taxpayers. The temporary rules are effective for taxable years beginning after December 31, 2021 and before the termination date. The termination date is the later of (i) January 1, 2025, or (ii) the date on which the Secretary of Health and Human Services makes a written certification that the Secretary of Health and Human Services has fully implemented the program described in section 1948 of the Social Security Act (relating to the Federal Medicaid program).

First, the proposal expands eligibility for the premium assistance credit to individuals and families with household incomes below 100 percent of FPL for a family of the size involved.

Second, the proposal expands eligibility for the premium assistance credit to an employee who is offered an affordable employer-sponsored health plan (and an individual who is eligible to enroll in the plan by reason of a relationship to the employee) that provides minimum value if (1) the taxpayer's household income does not exceed 138 percent of FPL for a family of the size involved, and (2) the employee (or individual) declines the employer-offered coverage. The proposal also expands eligibility to an employee (or any spouse or dependent of such employee) who is provided an affordable QSEHRA if the employee's household income does not exceed 138 percent of FPL for a family of the size involved.

Third, the proposal reduces the recapture limitation for a taxpayer whose household income is less than 200 percent of FPL for a family of the size involved from $650 (for 2021) to $300 ($150 for an unmarried individual who is not a surviving spouse or filing as a head of household).

Finally, the proposal provides special rules for certain taxpayers whom the Exchange has determined are low-income. For a taxpayer for any taxable year who would not be required to file an income tax return but for any requirement to reconcile advance payments, and who an Exchange determines (i) is eligible for advance payments of the premium tax credit for any portion of the taxable year and (ii) such taxpayer's household income is projected to not exceed 138 percent of FPL for a family of the size involved, the taxpayer is not subject to recapture and shall not be required to file such return. An Exchange is required to report to the Secretary and to the taxpayer information necessary to determine that the Exchange made the determinations described above with respect to the taxpayer. The employer shared responsibility provision is modified under the proposal to not be applicable if a premium assistance credit is allowed or paid for a taxable year of an employee where an Exchange has determined that the employee's household income for the taxable year is projected to not exceed 138 percent of FPL for a family of the size involved or such employee's household income for the taxable year does not exceed 138 percent of FPL for a family of the size involved.

**Extension of special rule for individuals receiving unemployment compensation**

The proposal temporarily extends the special rule enacted in ARPA for a taxpayer who has received, or has been approved to receive, unemployment compensation (as defined in

section 85(b)) for an applicable week.[219] Under the proposal, for any week beginning after December 31, 2020, and before January 1, 2026, for the taxable year in which such week begins, such taxpayer is treated as an applicable taxable and such taxpayer's household income is not taken into account to the extent it exceeds 150 percent of FPL for a family of the size involved.

**Effective Date**

The proposals are effective for taxable years beginning after December 31, 2021.

**2. Permanent credit for health insurance costs**

**Present Law**

**Eligible coverage months**

An eligible individual is allowed a refundable tax credit for 72.5 percent of the individual's premiums for qualified health insurance of the individual and qualifying family members for each eligible coverage month beginning in the taxable year.[220] The credit is commonly referred to as the health coverage tax credit. The credit is available only with respect to amounts paid by the individual for qualified health insurance. Advance monthly payments paid by the Secretary directly to the health plan administrator are available.[221]

Eligibility for the credit is determined on a monthly basis. In general, an eligible coverage month is any month if (1) the month begins before January 1, 2022, and (2) as of the first day of the month, (i) the individual is an eligible individual; (ii) is covered by qualified health insurance the premium for which is paid by the individual; (iii) does not have other specified coverage; and (iv) is not imprisoned under Federal, State, or local authority. In the case of a joint return, the eligibility requirements are met if at least one spouse satisfies the requirements.

**Eligible individuals**

An eligible individual is an individual who is (1) an eligible Trade Adjustment Assistance ("TAA") recipient, (2) an eligible alternative TAA recipient or an eligible reemployment TAA recipient, or (3) an eligible Pension Benefit Guaranty Corporation ("PBGC") pension recipient. In general, an individual is an eligible TAA recipient for a month if the individual (1) receives for any day of the month a trade readjustment allowance under the Trade Act of 1974 or would be eligible to receive such an allowance but for the requirement that the individual exhaust

[219] Sec. 36B(g).

[220] Qualifying family members are the individual's spouse and any dependent for whom the individual is entitled to claim a dependency exemption. Any individual who has certain specified coverage is not a qualifying family member.

[221] Sec. 7527.

unemployment benefits before being eligible to receive an allowance, and (2) with respect to such allowance, is covered under a required certification. An individual is an eligible alternative TAA recipient or an eligible reemployment TAA recipient for a month if the individual participates in certain programs under the Trade Act of 1974 providing wage supplements and receives a related benefit for the month. Generally, an individual is an eligible PBGC pension recipient for any month if the individual (1) is age 55 or over as of the first day of the month, and (2) receives a benefit for the month, any portion of which is paid by the PBGC. A person who may be claimed as a dependent on another person's tax return is not an eligible individual. In addition, an otherwise eligible individual is not eligible for the credit for a month if, as of the first day of the month, the individual has certain specified coverage, such as certain employer-provided coverage or coverage under certain governmental health programs.

**Qualified health insurance**

Qualified health insurance in respect of which the credit is allowed is: (1) coverage under a COBRA continuation provision;[222] (2) State-based continuation coverage provided by the State under a State law that requires such coverage; (3) coverage offered through a qualified State high risk pool; (4) coverage under a health insurance program offered to State employees or a comparable program; (5) coverage through an arrangement entered into by a State and a group health plan, an issuer of health insurance coverage, an administrator, or an employer; (6) coverage offered through a State arrangement with a private sector health care coverage purchasing pool; (7) coverage under a State-operated health plan that does not receive any Federal financial participation; (8) coverage under a group health plan that is available through the employment of the eligible individual's spouse; (9) coverage under individual health insurance[223] (other than coverage purchased through an American Health Benefit Exchange);[224] and (10) coverage under an employee benefit plan funded by a voluntary employee beneficiary association ("VEBA")[225] established pursuant to an order of a bankruptcy court (or by agreement with an authorized representative).[226]

Qualified health insurance does not include any State-based coverage (*i.e.*, coverage described in (2)-(7) in the preceding paragraph) unless the State has elected to have such coverage treated as qualified health insurance and such coverage meets certain consumer-

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[222] As defined in section 9832(d)(1).

[223] For this purpose, "individual health insurance" means any insurance that constitutes medical care offered to individuals other than in connection with a group health plan. Such term does not include Federal- or State-based health insurance coverage.

[224] The premium assistance credit is provided for eligible individuals and families who purchase health insurance through an American Health Benefit Exchange. See sec. 36B.

[225] As defined in section 501(c)(9).

[226] See 11 U.S.C. sec. 1114.

protection requirements.[227] Such State coverage must provide that each qualifying individual is guaranteed enrollment if the individual pays the premium for enrollment or provides a qualified health insurance costs eligibility certificate and pays the remainder of the premium. In addition, the State-based coverage cannot impose any pre-existing condition limitation with respect to qualifying individuals. State-based coverage cannot require a qualifying individual to pay a premium or contribution that is greater than the premium or contribution for a similarly situated individual who is not a qualified individual. Finally, benefits under the State-based coverage must be the same as (or substantially similar to) benefits provided to similarly situated individuals who are not qualifying individuals.

A qualifying individual for this purpose is an eligible individual who seeks to enroll in the State-based coverage and who has aggregate periods of creditable coverage[228] of three months or longer, does not have other specified coverage, and is not imprisoned.

Qualified health insurance does not include coverage under a flexible spending or similar arrangement or any insurance if substantially all of the coverage is for excepted benefits.

## Description of Proposal

The proposal makes the health coverage tax credit permanent (instead of expiring for months beginning on or after January 1, 2022). It also increases the amount of the credit from 72.5 percent of the individual's premiums for qualified health insurance to 80 percent.

## Effective Date

The provision is effective for coverage months beginning after December 31, 2021.

[227] For guidance on how a State elects a health program to be qualified health insurance for purposes of the credit, see Rev. Proc. 2004-12, 2004-1 C.B. 528.

[228] Creditable coverage is determined under section 9801(c).

## F. Funding for the Rural and Underserved Pathway to Practice Training Program for Post-Baccalaureate and Medical Students

### Present Law

The Code does not presently provide a tax credit to educational institutions for the purpose of subsidizing scholarship awards to post-baccalaureate and medical students who agree to practice in certain medically underserved or rural areas after graduation.

Generally, gross income of a scholarship recipient does not include any amount received as a qualified scholarship by a recipient who is a candidate for a degree at an education organization.[229] A "qualified scholarship" means any amount received by an individual as a scholarship or fellowship grant to the extent the individual establishes that, in accordance with the conditions of the grant, such amount was used for qualified tuition and related expenses.

### Description of Proposal

**Rural and Underserved Pathway to Practice Training Program for Post-Baccalaureate and Medical Students**

This proposal establishes section 1899C of the Social Security Act for the Rural and Underserved Pathway to Practice Training Program for Post-Baccalaureate and Medical Students (the "Program" or "Pathway to Practice"). This Program provides a scholarship and stipend for qualifying medical students to attend medical school and a post-baccalaureate program.

Students eligible for this program include first generation college or professional students; Pell Grant recipients; and those who lived in a medically underserved, rural, or health professional shortage area.

Beginning in 2023, the Secretary of Health and Human Services shall award 1,000 scholarships per year for certain "qualifying expenses," which include tuition, academic fees, textbooks and equipment, and a monthly stipend tied to the amount of the Armed Forces Health Professions Scholarship Program, which for 2021 is $2,540. The Secretary of Health and Human Services shall prioritize applications from those students who (1) participated in the Health Resources and Services Administration Health Careers Opportunity Program or were Area Health Education Center scholars, (2) are disadvantaged students (as defined by the National Health Service Corps), or (3) attended a historically black college or other minority serving institution.

Upon scholarship acceptance, the student agrees to complete medical school (and a post-baccalaureate program, if applicable), complete residency, and practice for at least one year per

[229] Sec. 117. For this purpose, an educational organization is an organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. Sec. 170(b)(1)(A)(ii).

scholarship year in a health professional shortage area, a medically underserved area, or a rural area.

If the student is not compliant with the terms of the scholarship, the student must repay the amounts, and the Secretary of Health and Human Services will collect these repayments with interest, except for the case of hardship.

**Pathway to Practice medical scholarship voucher credit**

The proposal creates a new refundable Pathway to Practice medical scholarship voucher credit for qualified educational institutions. The credit amount for a taxable year is equal to the aggregate amount paid or incurred by a qualified educational institution during the taxable year pursuant to a Pathway to Practice medical scholarship voucher awarded to a qualifying student enrolled at the institution.

Amounts are treated as paid or incurred pursuant to an annual award of a Pathway to Practice medical scholarship voucher only if such amount is paid or incurred in reimbursement, or anticipation of, a qualifying expense and is subject to verification in such manner as the Secretary of Health and Human Services may provide. In the case of any amount credited by a qualified educational institution against a liability owed by the qualifying student to the institution, such amount will be treated as paid by the institution to the student as of the date that the liability would otherwise be due.

The credit allowed to a qualified educational institution for a taxable year with respect to a Pathway to Practice medical scholarship voucher may not exceed the amount of the voucher, which is for qualifying expenses, reduced by any voucher amounts for which credit was allowed in any prior taxable years.

Qualified educational institutions are qualifying medical schools and providers of post-baccalaureate programs that meet the requirements of the Program.[230] A qualifying student is a student to whom the Secretary of Health and Human Services has made an annual award of a Pathway to Practice medical scholarship voucher. An annual award of a Pathway to Practice medical scholarship voucher is an award to a qualifying student for each year of enrollment in a post-baccalaureate program and a qualifying medical school, as appropriate.[231]

Information sharing

The proposal requires the Secretary of Health and Human Services to provide to the Secretary of the Treasury annually such information[232] regarding the Program as the Secretary of the Treasury may require to administer the credit, including information to identify (1) qualifying students and the qualified educational institutions at which such students are enrolled and (2) the

[230] Section 1899C(b)(2)(A) and (c)(6) of the Social Security Act, as added by this provision.

[231] Section 1899C(d)(3) of the Social Security Act, as added by this provision.

[232] Section 1899C of the Social Security Act, as added by this provision.

amount of each annual award of the Pathway to Practice medical scholarship voucher awarded to each qualifying student at the institution.

Income exclusion for medical scholarship voucher recipients

General rules under section 117 apply with respect to the Pathway to Practice medical scholarship vouchers awarded to qualifying students. A scholarship voucher recipient who is a candidate for a degree at an educational organization generally may exclude from gross income any amounts paid or incurred for qualified tuition and related expenses, in accordance with the conditions of the Pathway to Practice medical scholarship voucher.

## Effective Date

The proposal is generally effective for taxable years ending after the date of enactment.

## G. Higher Education

### 1. Credit for public university research infrastructure

**Present Law**

**General business credits**

For any taxable year, a taxpayer may be allowed a general business credit under section 38 against income tax, in an amount equal to the sum of the (1) business credit carryforwards carried to such taxable year, (2) the amount of the current year business credit, and (3) the business credit carrybacks carried to such taxable year.

The amount of the current year business credit is the sum of the credits identified in section 38(b)(2). The credit allowed for any taxable year is subject to the income tax liability restrictions under section 38(c).

**Charitable contributions in general**

An income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the recipient organization.[233] Charitable contributions of cash generally are deductible in the amount contributed.

The Code does not presently allow a general business credit for qualified cash contributions to a public university for research infrastructure.

**Percentage limitations on the deductible amount of charitable contributions made in cash**

Contributions by individuals

For individuals, in any taxable year, the amount deductible as a charitable contribution is limited to a percentage of the taxpayer's contribution base. The contribution base is defined as the taxpayer's adjusted gross income computed without regard to any net operating loss carryback. The applicable percentage of the contribution base varies depending on the type of recipient organization and property contributed.

Contributions by an individual taxpayer of cash and property (other than appreciated capital gain property) to a public charity[234] may not exceed 50 percent of the taxpayer's contribution base. For contributions taken into account for taxable years beginning after December 31, 2017, and before January 1, 2026, the percentage limit for contributions by an

[233] Sec. 170.

[234] For this purpose, the term "public charity" means an organization described in section 170(b)(1)(A), *e.g.*, public charities, private foundations other than private non-operating foundations, and certain governmental units.

individual taxpayer of cash to a public charity is increased to 60 percent.[235] A State college or university generally is treated as a public charity for this purpose; as such, a charitable contribution of cash to a State college or university generally qualifies for the percentage limits described in this paragraph.

Contributions by corporations

For corporations, in any taxable year, charitable contributions generally are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed with certain modifications.

Contributions by estates and trusts

Estates and certain trusts may generally deduct charitable contributions without a percentage limitation.[236]

Carryforwards of excess contributions

Charitable contributions that exceed the applicable percentage limitation may be carried forward for up to five years.[237] The amount that may be carried forward from a taxable year ("contribution year") to a succeeding taxable year may not exceed the applicable percentage of the contribution base for the succeeding taxable year less the sum of contributions made in the succeeding taxable year plus contributions made in taxable years prior to the contribution year and treated as paid in the succeeding taxable year under this rule.

Temporary modifications to charitable contribution limitations

A temporary rule increases the percentage limits for individuals and corporations for certain cash contributions paid during 2020 or 2021.[238]

## Description of Proposal

The proposal adds a new public university research infrastructure credit as part of the section 38 general business credit.

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[235] Sec. 170(b)(1)(G).

[236] Sec. 642(c).

[237] Sec. 170(d).

[238] In general, cash contributions by an individual taxpayer made during 2020 and 2021 to certain public charities are allowed up to the amount by which the taxpayer's contribution base exceeds the deduction for other charitable contributions. In the case of a corporation, the deduction for such contributions is allowed up to 25 percent of the corporation's taxable income. See Pub. L. No. 116-260 (December 27, 2020), Div. EE, sec. 213 (extending section 2205 of the CARES Act, Pub. L. No. 116-136 (March 27, 2020)).

**Amount of credit and definitions**

The credit for a taxable year is an amount equal to 40 percent of the qualified cash contributions made by a taxpayer during the taxable year.[239]

For this purpose, a qualified cash contribution for a taxable year is the aggregate amount contributed in cash by a taxpayer during such taxable year to a certified educational institution in connection with a qualifying project, provided that the contribution would have been treated as a charitable contribution for purposes of the income tax charitable deduction (section 170(c) of the Code), if the credit were not available.[240] A contribution is treated as a qualified cash contribution only to the extent that it is designated as such by a certified educational institution, as outlined below. No other credit or deduction is allowed for a qualified cash contribution for which is credit is allowed under the proposal.

The term "qualifying project" means a project to purchase, construct, or improve research infrastructure property. The term "research infrastructure property" means any portion of a property, building, or structure of an eligible educational institution, or any land associated with such property, building, or structure, that is used for research. An "eligible educational institution" is: (1) an institution of higher education (as defined in section 101 or 102(c) of the Higher Education Act of 1965) that is a college or university described in section 511(a)(2)(B) (generally describing State colleges and universities); or (2) an organization described in section 170(b)(1)(A)(iv)[241] or a supporting organization described in section 509(a)(3) to which authority has been delegated by an institution of higher education described in (1), above, for purposes of applying for or administering credit amounts on behalf of such institution.

As indicated above, a qualified cash contribution must be made to a certified educational institution. The term "certified educational institution" means an eligible educational institution that has been allocated a credit amount for a qualifying project, has received a certification for the project (as described below), and designates credit amounts to taxpayers for qualifying cash contributions toward such project (as also described below).

**Establishment of qualifying university research infrastructure program**

The proposal requires the Secretary, in consultation with the Secretary of Education, to establish the qualifying university research infrastructure program within 180 days of the date of enactment. The program must: (1) certify and allocate credit amounts for qualifying projects to

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[239] No other credit or deduction is allowed for a qualified cash contribution for which a credit is allowed under the provision. In addition, in the case of a trust or estate, rules similar to the rules of section 52(d) (generally relating to the apportionment of the credits between the trust or estate and the beneficiaries) shall apply.

[240] A qualified cash contribution for which a credit is allowed is taken into account in determining the taxpayer's annual percentage limitations for purposes of the income tax charitable deduction under section 170(b).

[241] Section 170(b)(1)(A)(iv) describes certain organizations organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a State college or university.

eligible educational institutions; and (2) allow certified educational institutions to designate cash contributions for qualifying projects of such institutions as qualified cash contributions.

The total amount of qualifying project credit amounts that may be allocated shall not exceed $500 million for each of calendar years 2022, 2023, 2024, 2025, and 2026, and $0 for each subsequent year. Any portion of this overall limitation that remains unallocated during a calendar year is carried to the succeeding calendar year and added to the limitation allowable for such succeeding year. Credit amounts allocated to any one certified educational institution for all projects shall not exceed $100 million per calendar year.

The Secretary, after consultation with the Secretary of Education, must select applications from eligible education institutions: (1) based on the extent of the expected expansion of the institution's targeted research within disciplines in science, mathematics, engineering, and technology; and (2) in a manner that ensures consideration is given to institutions with full-time student populations of less than 12,000. The proposal also requires the Secretary, after consultation with the Secretary of Education, to establish a process by which certified educational institutions must designate cash contributions to such institution as qualified cash contributions.

The aggregate amount of cash contributions which are designated by a certified educational institution as qualifying cash contributions with respect to any qualifying project may not exceed 250 percent of the credit amount allocated by the Secretary. For example: The Secretary allocates a $100 million credit amount to a certified educational institution for a qualifying project. The institution may designate up to $250 million (250 percent of $100 million) in qualifying cash contributions. These qualifying cash contributions, in turn, may generate up to $100 million (40 percent of $250 million) in credits for taxpayers. Thus, each dollar of credit amount is equal to a dollar of credit.

The proposal requires disclosure of allocations and designations. The Secretary is required, upon allocating credit amounts to an applicant, to publicly disclose the identity of the applicant and the credit amount allocated to the applicant. Each certified educational institution shall, upon designating contributions of a taxpayer as qualified cash contributions, publicly disclose the identity of the taxpayer and the amount of contributions designated in such time, form, and manner as the Secretary may require.

**Regulations and other guidance**

The proposal requires the Secretary, after consultation with the Secretary of Education, to prescribe such regulations and other guidance as may be necessary or appropriate to carry out the purposes of the provision, including regulations for prevention of abuse, establishment of reporting requirements, establishment of selection criteria for applications, and disclosure of allocations.

**Penalties for noncompliance**

The proposal includes rules that apply if, at any time during the five-year period beginning on the date of the allocation of credit amounts to a certified educational institution, there is a noncompliance event with respect to such credit amounts. In general, in the case of a

noncompliance event, any cash contribution designated as a qualifying cash contribution with respect to a qualifying project for which such credit amounts were allocated shall be treated as unrelated business taxable income (within the meaning of section 512) of the certified educational institution. In addition, where (1) there is a failure to designate cash contributions as qualified cash contributions within the two years after December 31 of the year in which the credit amount was allocated (as described below), and (2) the Secretary identified such unused credits during a review by the Secretary (as also described below), the Secretary shall reallocate such unused credit amounts to other certified education institutions in lieu of imposing the general rule described in the preceding sentence.

The term "noncompliance event" means, with respect to a credit amount allocated to a certified educational institution: (1) cash contributions equaling the amount of such credit amount are not designated as qualified cash contributions within two years after December 31 of the year such credit amount is allocated; (2) a qualifying project with respect to which such credit amount was allocated is not placed in service within either (a) four years after December 31 of the year such credit amount is allocated or (b) a period of time that the Secretary determines is appropriate; or (3) the research infrastructure property placed in service as part of a qualifying project with respect to which such credit amount was allocated ceases to be used for research within five years after such property is placed in service.

**Review and reallocation of credit amounts**

Not later than five years after the date of enactment, the Secretary shall review the credit amounts allocated under the proposal. The Secretary may reallocate credit amounts allocated under the proposal if the Secretary determines, as of the date of the review, that such credit amounts are subject to a noncompliance event. If the Secretary determines that credits are available for reallocation, the Secretary is authorized to conduct an additional program for applications for certification, but the Secretary shall not certify any project, or reallocate any credit amount after December 31, 2031.

**Termination**

The proposal does not apply to qualified cash contributions made after December 31, 2033.

**Effective Date**

The proposal is effective for qualified cash contributions made after December 31, 2021.

**2. Modification of excise tax on investment income of private colleges and universities**

**Present Law**

Section 4968 imposes an excise tax on an applicable educational institution for each taxable year equal to 1.4 percent of the net investment income of the institution for the taxable year. Net investment income is determined using rules similar to the rules of section 4940(c) (relating to the net investment income of a private foundation).

An applicable educational institution is an eligible educational institution (as defined in section 25A):[242] (1) that has at least 500 tuition-paying students during the preceding taxable year; (2) more than 50 percent of the tuition-paying students of which are located in the United States; (3) that is not described in the first section of section 511(a)(2)(B) (generally describing State colleges and universities); and (4) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose)[243] is at least $500,000 per student. For these purposes, the number of students of an institution is based on the average daily number of full-time students attending the institution, with part-time students being taken into account on a full-time student equivalent basis.

For purposes of determining whether an educational institution meets the asset-per-student threshold[244] and for purposes of determining net investment income, assets and net investment income of a related organization with respect to the educational institution are treated as assets and net investment income, respectively, of the educational institution, except that:

- No such amount is taken into account with respect to more than one educational institution; and
- Unless the related organization is controlled by the educational institution or is a supporting organization (described in section 509(a)(3)) with respect to the institution for the taxable year, assets and net investment income that are not intended or available for the use or benefit of the educational institution are not taken into account. For example, assets of a related organization that are earmarked or restricted for (or fairly attributable to) the educational institution would be treated as assets of the educational institution, whereas assets of a related organization that are held for unrelated purposes (and are not fairly attributable to the educational institution) would be disregarded.

An organization is treated as related to the institution for this purpose if the organization: (1) controls, or is controlled by, the institution; (2) is controlled by one or more persons that

[242] Section 25A(f)(2) defines an eligible educational institution as an institution that (1) is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. sec. 1088), as in effect on August 5, 1977, and (2) is eligible to participate in a program under title IV of such Act.

[243] Assets used directly in carrying out the institution's exempt purpose include, for example, classroom buildings and physical facilities used for educational activities and office equipment or other administrative assets used by employees of the institution in carrying out exempt activities, among other assets.

[244] In cross-referencing the asset-per-student threshold for this purpose, section 4968(d)(1) includes a reference to subsection "(b)(1)(C)" that should instead read "(b)(1)(D)." A clerical correction may be necessary to correct this cross-reference.

control the institution; or (3) is a supported organization[245] or a supporting organization[246] during the taxable year with respect to the institution.

## Description of Proposal

### Phaseout of excise tax

The proposal provides for a phaseout of the section 4968 excise tax for certain institutions providing qualified aid awards. The amount of excise tax determined under section 4968(a) (without regard to the phaseout rules) is reduced (not below zero) by the amount that bears the same ratio to such amount of tax as (1) the excess (if any) of (a) the aggregate amount of qualified aid awards provided by the institution to its first-time, full-time undergraduate students for academic periods beginning during the taxable year, over (b) an amount equal to 20 percent of the aggregate undergraduate tuition and fees received by the institution from first-time, full-time undergraduate students for such academic periods, bears to (2) an amount equal to 13 percent of such aggregate undergraduate tuition and fees so received.

For this purpose, the term "first-time, full-time undergraduate student" has the same meaning as when used in section 132 of the Higher Education Act of 1965.[247] The term "qualified aid awards" means, with respect to an applicable educational institution, grants and scholarships to the extent used for undergraduate tuition and fees. The term "undergraduate tuition and fees" means, with respect to any institution, the tuition and fees required for the enrollment or attendance of a student as an undergraduate student at the institution.

To qualify for the excise tax phaseout described above, an institution must meet certain reporting requirements. The institution must furnish to the Secretary, and make widely available, a statement detailing the average aggregate amount of Federal student loans received by a student for attendance at the institution, averaged among each of the following groups of first-time, full-time undergraduate students who during the taxable year completed a course of study for which the institution awarded a baccalaureate degree: (1) all such students; (2) the students who have been awarded a Federal Pell Grant under subpart 1 of part A of title IV of the Higher Education Act of 1965 for attendance at the institution; (3) the students who received work-study assistance under part C of title IV of such Act for attendance at such institution; and (4) the students who were provided such Federal student loans. For this purpose, the term "Federal student loans" means a loan made under part D of title IV of the Higher Education Act of 1965, except such term does not include a Federal Direct PLUS Loan made on behalf of a dependent student. The statement must be furnished at such time and in such form and manner, and made widely available, under such regulations as the Secretary may prescribe.

Example.–Institution A is an applicable educational institution. Its excise tax liability computed under section 4968(a) (without regard to the phaseout rules) for taxable year 2023 is

[245] Sec. 509(f)(3).

[246] Sec. 509(a)(3).

[247] 20 U.S.C. 1015a.

$2 million. Institution A provides $25 million in qualified aid awards to its first-time, full-time undergraduate students for academic periods beginning during the taxable year. Institution A receives $100 million in aggregate undergraduate tuition and fees from its first-time, full-time undergraduate students for such academic periods. Because Institution A satisfied the above-described reporting requirements, it is eligible to reduce its excise tax liability under the proposal. To compute Institution A's reduction in excise tax liability, one must first determine the ratio of (a) the excess of its qualified aid awards in excess of 20 percent of its undergraduate tuition and fees to (b) 13 percent of such tuition and fees. This ratio can be expressed as follows: ($25 million - (20% of $100 million, or $20 million)) / (13% of $100 million, or $13 million) = 5/13. This ratio is then applied to the amount of Institution A's excise tax liability to determine the amount of Institution A's reduction in tax liability ($2 million excise tax liability x (5 / 13) = $769,231 phaseout of excise tax liability). Institution A could fully phase out its $2 million excise tax liability by making qualified aid awards equal to or greater than 33 percent of its aggregate undergraduate tuition and fees, or $33 million (($33 million - (20% of $100 million, or $20 million)) / (13% of $100 million, or $13 million) = 13/13, or 1).

**Inflation adjustment and clarification**

In the case of any taxable year beginning after 2022, the $500,000-per-student asset threshold used for determining whether an institution is an applicable educational institution is adjusted for inflation. In addition, the requirement that an applicable educational institution must have had at least 500 tuition-paying students during the preceding taxable year is clarified to apply only to tuition-paying students below the graduate level. Thus, for example, the excise tax would not apply to a graduate-only institution.

**Effective Date**

The proposal is effective for taxable years beginning after December 31, 2021.

**3. Treatment of Federal Pell Grants for income tax purposes.**

**Present Law**

**Qualified scholarships**

Present law provides an exclusion from gross income for amounts received as a qualified scholarship by an individual who is a candidate for a degree at a qualifying educational organization.[248] In general, a qualified scholarship is any amount received by such an individual as a scholarship or fellowship grant if the amount is used for qualified tuition and related expenses.

Qualified tuition and related expenses include tuition and fees required for enrollment or attendance, or fees, books, supplies, and equipment required for courses of instruction, at the

[248] Sec. 117.

qualifying educational organization.[249] This definition does not include regular living expenses, such as room and board. A qualifying educational organization is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.[250]

The exclusion for qualified scholarships does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship.[251] Instead, amounts received as a qualified scholarship that constitute payments for such services are included in gross income and wages. An exception to this rule applies in the case of the National Health Services Corps Scholarship Program, the Armed Forces Health Professions Scholarship and Financial Assistance Program, and a comprehensive student work-learning-service program operated by a work college. Amounts received as a qualified scholarship that represent payment for teaching, research, or other services by the student that are required under these programs is excluded from gross income and wages.

**American Opportunity Tax Credit and Lifetime Learning Credit**

The American Opportunity Tax Credit ("AOTC") is a partially refundable income tax credit for certain costs associated with postsecondary education. The amount of the AOTC is 100 percent of the first $2,000 of qualifying expenses and 25 percent of the next $2,000 of these expenses. The AOTC is determined on a per-student basis, with a maximum credit of $2,500 for any single eligible student.[252] As an example of the per-student calculation, a taxpayer who pays $4,000 or more of qualified expenses for each of two eligible students may, subject to other AOTC rules, be allowed a credit of $5,000.

Expenses for which the credit are allowed are qualified tuition and related expenses that an individual pays in the taxable year for education furnished in any academic period that begins in that year to an eligible student for whom an election is in effect for the year.[253]

Qualified tuition and related expenses are tuition, fees, and course materials required for the taxpayer's, the taxpayer's spouse's, or the taxpayer's dependent's enrollment or attendance at an eligible educational institution for courses of instruction.[254] Qualified tuition and related expenses do not, however, include (1) expenses for any course or other education involving sports, games, or hobbies unless the course or other education is part of the individual's degree

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[249] Sec. 117(b)(2).

[250] Sec. 117(a); sec. 170(b)(1)(A)(ii).

[251] Sec. 117(c).

[252] See Treas. Reg. sec. 1.25A-3(b).

[253] Sec. 25A(a)(1), (b)(1).

[254] Sec. 25A(f)(1)(A), (D).

program or (2) student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.[255] Examples of non-qualifying expenses are room and board and transportation expenses.[256]

The Lifetime Learning Credit (also in section 25A) generally allows a taxpayer a 20-percent credit for up to $10,0000 in qualified tuition and related expenses that the taxpayer pays during a taxable year for education furnished in an academic period beginning that year.[257] Qualified tuition and related expenses taken into account for the AOTC may not be taken into account for determining the Lifetime Learning Credit.[258]

For the purpose of determining the amount of the AOTC and the Lifetime Learning Credit, qualified tuition and related expenses that may be taken into account for an individual for any academic period must be reduced by the amount of tax-free educational assistance that is paid for the benefit of that individual and is allocable to that period.[259] For this purpose, tax-free educational assistance means a qualified scholarship that is excludable from gross income under section 117; a veterans or member-of-the-armed-forces educational assistance allowance under certain provisions of the U.S. Code; employer-provided educational assistance that is excludable from income under section 127; or any other educational assistance that is excludable from gross income (other than as a gift, bequest, devise, or inheritance within the meaning of section 102(a)).[260]

## Description of Proposal

The proposal expands the definition of a qualified scholarship excludable from gross income to include any amount received by an individual as a Federal Pell grant under section 401 of the Higher Education Act of 1965. To the extent Federal Pell grants are used for qualified tuition and related expenses, they are excluded from gross income under present law. To the extent Federal Pell grants are used for expenses that are not qualified tuition and related expenses, such as room and board, the proposal would exclude such amounts from gross income.

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[255] Sec. 25A(f)(1)(B), (C).

[256] See Treas. Reg. sec. 1.25A-2(d)(3).

[257] Sec. 25A(a)(2), (c). In contrast with the AOTC, the Lifetime Learning Credit is a per-taxpayer (rather than per-student) credit. As a consequence, the maximum Lifetime Learning Credit is $2,000. In contrast with the AOTC scope of qualifying expenses, qualified tuition and related expenses for the Lifetime Learning Credit do not include course materials. See sec. 25A(f)(1)(D). By contrast, for the Lifetime Learning Credit, solely for purposes of the Lifetime Learning Credit, qualified tuition and related expenses includes required tuition and fees with respect to any course of instruction at an eligible educational institution to acquire or improve job skills of the individual. Sec. 25A(c)(2)(B).

[258] Sec. 25A(c)(2)(A).

[259] Secs. 25A(g)(2); Treas. Reg. sec. 1.25A-5(c).

[260] Treas. Reg. sec. 1.25A-5(c)(1).

Under the proposal, the amount of expenses eligible for the AOTC or the Lifetime Learning Credit shall not be reduced by any amount paid for the benefit of an individual as a Federal Pell grant.

**Effective Date**

The amendments made by the proposal shall apply to taxable years beginning after December 31, 2021.

### 4. Repeal of denial of American Opportunity Tax Credit on basis of felony drug conviction

**Present Law**

**In general**

The American Opportunity Tax Credit ("AOTC") is a partially refundable income tax credit for certain costs associated with postsecondary education.[261] The amount of the AOTC is 100 percent of the first $2,000 of qualifying expenses and 25 percent of the next $2,000 of these expenses.

The AOTC is determined on a per-student basis, with a maximum credit of $2,500 for any single eligible student.[262] As an example of the per-student calculation, a taxpayer who pays $4,000 or more of qualified expenses for each of two eligible students may, subject to other AOTC rules, be allowed a credit of $5,000.

Expenses for which the credit are allowed are qualified tuition and related expenses that an individual pays in the taxable year for education furnished in any academic period that begins in that year to an eligible student for whom an election is in effect for the year.[263]

Qualified tuition and related expenses are tuition, fees, and course materials required for the taxpayer's, the taxpayer's spouse's, or the taxpayer's dependent's enrollment or attendance at an eligible educational institution for courses of instruction.[264] Qualified tuition and related

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[261] Sec. 25A.

[262] See Treas. Reg. sec. 1.25A-3(b).

[263] Sec. 25A(a)(1), (b)(1). Generally, the AOTC is allowed only for qualified tuition and related expenses that are paid for an academic period that begins in the year of payment. Sec. 25A(b)(1). For example, under this rule the credit would not be allowed for a payment in December 2020 for a winter semester beginning in January 2021. Under a special prepayment rule, if a taxpayer pays qualified tuition and related expenses during a year for an academic period that starts in the first three months of the next year, that academic period is treated as beginning during the earlier year of payment. Sec. 25A(g)(4).

[264] Sec. 25A(f)(1)(A), (D). For the purpose of determining the amount of the AOTC, qualified tuition and related expenses that may be taken into account for an individual for any academic period must be reduced by the amount of tax-free educational assistance that is paid for the benefit of that individual and is allocable to that period. Sec. 25A(g). For this purpose, tax-free educational assistance means a qualified scholarship that is excludable from gross income under section 117; a veterans or member-of-the-armed-forces educational assistance allowance under

expenses do not, however, include (1) expenses for any course or other education involving sports, games, or hobbies unless the course or other education is part of the individual's degree program or (2) student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.[265] Examples of non-qualifying expenses are room and board and transportation expenses.[266]

**Income-based phaseout and refundability**

The AOTC is reduced or eliminated for taxpayers with incomes above certain levels. For a taxpayer other than a married individual filing a joint return, the amount of the AOTC otherwise allowed is reduced ratably over a $10,000 phaseout range by the excess of the taxpayer's modified AGI over $80,000. For a taxpayer that does not file a joint return, therefore, the credit is fully phased out at $90,000 of modified AGI. The phaseout range for a married taxpayer filing a joint return is $160,000 to $180,000 of modified AGI.[267] For purposes of the phaseout, modified AGI means AGI increased by any amount excluded from gross income under section 911 (foreign earned income exclusion), section 931 (exclusion for a bona fide resident of American Samoa), or section 933 (exclusion for a bona fide resident of Puerto Rico).[268]

Forty percent of the amount of the AOTC otherwise determined (after application of any income-based reduction) is treated as a refundable credit except in the case of a taxpayer who is a child to whom the section 1(g) "kiddie tax" applies.[269]

**Restrictions**

The AOTC is subject to several restrictions in addition to the dollar limitations and the income-based phaseout. The credit may be claimed in respect of an eligible student for only four taxable years.[270] The AOTC is allowed for a taxable year in respect of the qualified tuition and related expenses of an individual only if the individual is an eligible student for at least one academic period that starts during that year. The AOTC is allowed for a taxable year in respect of an eligible student's qualified tuition and related expenses only if the student has not already completed (before the beginning of the year) the first four years of post-secondary education at an eligible educational institution.

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certain provisions of the U.S. Code; employer-provided educational assistance that is excludable from income under section 127; or any other educational assistance that is excludable from gross income (other than as a gift, bequest, devise, or inheritance within the meaning of section 102(a)).

[265] Sec. 25A(f)(1)(B), (C).

[266] See Treas. Reg. sec. 1.25A-2(d)(3).

[267] Sec. 25A(d)(1).

[268] Sec. 25A(d)(2).

[269] Sec. 25A(i).

[270] Sec. 25A(b)(2).

The credit is not allowed for qualified tuition and related expenses for a student's enrollment or attendance for any academic period if the student has been convicted of a Federal or State felony drug possession or distribution offense before the end of the taxable year with or within which the academic period ends.[271]

A taxpayer who is a married individual (within the meaning of section 7703) may claim the AOTC in a taxable year only if the taxpayer and the taxpayer's spouse file a joint return for that year.[272] A taxpayer who is a nonresident alien individual for any portion of the taxable year may claim the AOTC for that year only if the individual is treated as a resident alien for the year because an election is made under section 6013(g) or (h) (resident alien election for certain married individuals).[273]

The AOTC is allowed only if certain identification requirements related to the taxpayer, the student, and the educational institution are satisfied and only if the taxpayer receives a payee statement from the educational institution to which the qualified tuition and related expenses are paid.[274]

**Rules for eligible students and eligible educational institutions**

For purposes of the rules for determining the amount of the AOTC and the rules limiting the AOTC, an eligible student is, for any academic period, a student who carries at least half the normal full-time work load for the course of study the student is pursuing and who satisfies certain requirements prescribed by the Higher Education Act of 1965 for eligibility for Federal grants, loans, and work assistance.[275]

An eligible educational institution is an institution that is described in section 481 of the Higher Education Act of 1965[276] as in effect on August 5, 1997 (generally all accredited public, nonprofit, and private postsecondary institutions) and that participates or is eligible to participate in a Federal financial aid program under title IV of the Higher Education Act of 1965.[277]

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[271] Sec. 25A(b)(2)(D).

[272] Sec. 25A(g)(6).

[273] Sec. 25A(g)(7).

[274] See sec. 25A(g)(1), (g)(8). Payee statements generally are provided on a Form 1098-T. Prop. Treas. Reg. sec. 1.25A-1(f); Treas. Reg. sec. 1.6050S-1(b)(2).

[275] Sec. 25A(b)(3).

[276] 20 U.S.C. sec. 1088.

[277] Sec. 25A(f)(2); Treas. Reg. sec. 1.25A-2(b)(1).

**Disallowance for prior fraudulent, reckless, or improper claims**

The AOTC is disallowed for certain periods after a taxpayer has made a fraudulent, reckless, or other improper claim for the credit.[278] If there is a final determination that a taxpayer's claim of the AOTC is fraudulent, the taxpayer is not allowed the AOTC for the 10 taxable years after the year of the fraudulent claim. If there is a final determination that a taxpayer's claim of the AOTC is due to reckless or intentional disregard of rules and regulations, the taxpayer is not allowed the AOTC for the two taxable years after the reckless claim. If a taxpayer makes an AOTC claim that is not determined to be fraudulent or reckless but that the IRS denies by notice of deficiency, the taxpayer is not allowed the AOTC for any subsequent year unless the taxpayer provides such information that the Secretary may require to demonstrate eligibility for the credit.

## Description of Proposal

The proposal repeals the restriction that the AOTC is not allowed for qualified tuition and related expenses for a student's enrollment or attendance for any academic period if the student has been convicted of a Federal or State felony drug possession or distribution offense before the end of the taxable year with or within which the academic period ends.

## Effective Date

The amendments made by the proposal shall apply to taxable years beginning after December 31, 2021.

[278] Sec. 25A(b)(4).