

Advances of the child tax credit are messier than you may think

Beginning this July, the American Rescue Plan (ARP) requires the IRS to send advances of the child tax credit to qualified parents. The advance credit ranges from a maximum of \$3,600 for kids under six to \$3,000 for kids up to age 17 (\$250 to \$300 a month). These monthly advances are scheduled to run through the end of the year.

The intention is laudable; it's expensive to bring up kids, and the pandemic has made things worse for many families. But advance credits are tricky, and the tax and payroll problems are just now becoming evident.

Let's take the payroll problems first.



No double-dipping

We're back to our old friend — no double-dipping. In other words, you can't get the benefit of the same tax credit twice. Or, as it turns out, two times, for payroll purposes. First, Step 3 of the new Form W-4 allows employees to figure the child tax credit directly into their withholding.

However, a double-dip may occur for employees who filled in this portion of their W-4s. We're saying *may occur* because there are phase-outs to the advance of the child tax credit. So some employees may not receive any advance credit.

What about employees who have old W-4s on file and W-4s based on the computational bridge? The computational bridge part of the answer is easy — you don't need to do anything. Calculations for computational bridge W-4s bypass Step 3.

Employees with pre-2020 W-4s on file may be claiming withholding allowances for each dependent. For 2021, the annual amount of one withholding allowance is \$4,300 and the credit ranges from \$3,000 to \$3,600, depending on kids' ages. We think these employees should be fine, but if they ask, you should politely tell them to consult a tax advisor.

The ARP directs the IRS to coordinate the advance credit with withholding. So we'll be expecting some sort of official guidance. But time is running short for the IRS to deal with this since any changes to the W-4 and withholding usually require months of testing.

The second double-dip involves dependent care assistance plans. Employees who are participating in a DCAP might want to think about reducing their pretax contributions by the amount of the advance they receive. This would ease reconciliations on [Form 2441](#) next winter.

The Consolidated Appropriations Act allows employees to make pretax changes, provided the changes are prospective.

Advance credit complications

Advances of tax credits are tricky because you're getting the money in hand long before you're determined to be eligible for any credit. The amount advanced vs. the amount you are eligible to receive must be reconciled on your 1040, and the math can be quite difficult. If you have underestimated your adjusted gross income, and therefore overestimated your eligibility for a credit, you'll have to pay back some or all of the credit, and a lump-sum payment may be difficult to come by.

And then there are the phase-outs. The child tax credit has always had phase-out provisions. The modified adjusted gross income threshold at which the credit begins to be phased out is \$400,000 for marrieds filing jointly and \$200,000 for single taxpayers and heads of household. The credit amount is reduced by \$50 for each \$1,000 of modified AGI over the \$400,000/\$200,000 amounts.

The advance credit also requires a second phase-out. Here, the applicable threshold amounts are lower than the first phase-out:

- \$150,000 for taxpayers filing jointly or surviving spouses.
- \$112,500 for the head of household.
- \$75,000 for single taxpayers.

The amount of child tax credit is reduced by \$50 for each \$1,000 of modified AGI over the applicable threshold amount.

But there are other problems with the advance credit, including:

- Accounting for employees who change their marital status.
- The death of a child.
- Apportioning the credit between divorced spouses who have joint custody.

No, thanks

The CAA also requires the IRS to set up a portal through which employees will be able to opt-out of the advance payment. Those who opt out should be able to claim the full credit on their 2021 1040s without having to

perform any burdensome reconciliation.