

IRS Issues FAQs for Families and Small Employers for New Tax Credits

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The Internal Revenue Service has posted two new, separate sets of frequently-asked-questions (FAQs) to assist [families](#) and [small and mid-sized employers](#) in claiming credits under the American Rescue Plan (ARP).

Both the child and dependent care credit as well as the paid sick and family leave credit were enhanced under the ARP, enacted in March to assist families and small businesses with the fallout of the COVID-19 pandemic and recovery underway. The two sets of FAQs provide information on eligibility, computing the credit amounts, and how to claim these important tax benefits. An overview of these tax credits follows:

Child and dependent care credit for 2021, the ARP increased the maximum amount of work-related expenses for qualifying care that may be taken into account in calculating the credit, increased the maximum percentage of those expenses for which the credit may be taken, modified how the credit is reduced for higher earners, and made it refundable.

For 2021, eligible taxpayers can claim qualifying work-related expenses up to:

- \$8,000 for one qualifying person, up from \$3,000 in prior years, or
- \$16,000 for two or more qualifying persons, up from \$6,000 in prior years.

Taxpayers are also required to have earnings; the amount of qualifying work-related expenses claimed cannot exceed the taxpayer's earnings.

Combined with the increase to 50% in the maximum credit rate, taxpayers with the maximum amount of qualifying work-related expenses would receive a

credit of \$4,000 for one qualifying person, or \$8,000 for two or more qualifying persons. When calculating the credit, a taxpayer must subtract employer-provided dependent care benefits, such as those provided through a flexible spending account, from total work-related expenses.

A qualifying person generally is a dependent under the age of 13, or a dependent of any age or spouse who is incapable of self-care and who lives with the taxpayer for more than half of the year.

As in prior years, the more a taxpayer earns, the lower the percentage of work-related expenses that are taken into account in determining the credit. However, under the new law, more taxpayers will qualify for the new maximum 50% credit rate. That's because the ARP increased to \$125,000 the adjusted gross income level at which the credit rate starts to be reduced. Above \$125,000, the 50% credit percentage goes down as income rises. Taxpayers with adjusted gross income over \$438,000 are not eligible for the credit.

The credit is fully refundable for the first time in 2021. This means an eligible taxpayer can receive it, even if they owe no federal income tax. To be eligible for the refundable credit, a taxpayer (or the taxpayer's spouse if filing a joint return) must reside in the United States for more than half of the year. However, special rules apply to military personnel stationed outside of the United States.

To claim the credit for 2021, taxpayers will need to complete Form 2441, *Child and Dependent Care Expenses*, and include the form when filing their tax returns in 2022. In completing the form to claim the 2021 credit, those claiming the credit will need to provide a valid taxpayer identification number (TIN) for each qualifying person. Generally, this is the Social Security number for the qualifying person. For more information about completing the form and claiming the credit, see the instructions to Form 2441. In addition, those claiming the credit are required to identify all persons or organizations that provided care for the qualifying person. This requires providing the care provider's name, address, and TIN.

Paid sick and family leave credits

The paid sick and family leave credits reimburse eligible employers for the cost of providing paid sick and family leave to their employees for reasons related to

COVID-19, including leave taken by employees to receive or recover from COVID-19 vaccinations. Self-employed individuals are eligible for similar tax credits.

The paid sick and family leave tax credits under the ARP are similar to those put in place by the Families First Coronavirus Response Act (FFCRA), as extended and amended by the COVID-related Tax Relief Act of 2020, under which certain employers could receive tax credits for providing paid leave to employees that met the requirements of the Emergency Paid Sick Leave Act and the Emergency Family and Medical Leave Expansion Act (as added by FFCRA). The ARP amends and extends these credits, and provides that leave wages paid to an employee who is seeking or awaiting the results of a test for, or diagnosis of, COVID-19, or is obtaining immunizations related to COVID-19 or recovering from immunization, are leave wages that can be eligible for the credits. Additionally, under the ARP, eligible employers may now claim the credit for paid family leave wages for all the same reasons that they can claim the credit for paid sick leave wages.

The FAQs include information on how eligible employers may claim the paid sick and family leave credits, including how to file for and compute the applicable credit amounts, and how to receive advance payments for and refunds of the credits. Under the ARP, eligible employers, including businesses and tax-exempt organizations with fewer than 500 employees and certain governmental employers, may claim tax credits for qualified leave wages and certain other wage-related expenses (such as health plan expenses and certain collectively bargained benefits) paid with respect to leave taken by employees beginning on April 1, 2021, through September 30, 2021.

The ARP keeps the daily wage thresholds that previously existed for these credits under the FFCRA. The aggregate cap on qualified sick leave wages remains at two weeks (up to a maximum of 80 hours), and this aggregate cap reset with respect to leave taken by employees beginning on April 1, 2021. The aggregate cap on qualified family leave wages increases to \$12,000 from \$10,000, and this aggregate cap reset with respect to leave taken by employees beginning on April 1, 2021.

The paid leave credits under the ARP are tax credits against the employer's share of Medicare tax. The tax credits are refundable, which means that the employer is entitled to payment of the full amount of the credits to the extent it exceeds the employer's share of Medicare tax.

In anticipation of the credits to be claimed on the applicable federal employment tax return, eligible employers can keep the federal employment taxes that they otherwise would have deposited, including federal income tax withheld from employees, the employees' share of social security and Medicare taxes, and the employer's share of social security and Medicare taxes with respect to all employees up to the amount of the credit for which they are eligible. If the eligible employer does not have enough federal employment taxes on deposit to cover the amount of the anticipated credits, the eligible employer may request an advance of the credit by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19.

Self-employed individuals may claim comparable credits on the Form 1040, U.S. Individual Income Tax Return.

More information on tax provisions of the American Rescue Plan can be found [here](#). Other provisions designed to help taxpayers recovering from the impact of the COVID-19 pandemic can be found [here](#). FAQs on these and other provisions can be found [here](#).

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