Advance Child Tax Credit (ACTC): Answers to Common Questions

Many American families are receiving Advance Child Tax Credit payments starting July 15. Here's what you need to know about the changes to the child tax credit, choices you can make, and planning for 2021 taxes.

The ACTC is an advance payment of half of the expanded child tax credit (CTC) made available under the American Rescue Plan. The remainder of the credit gets settled up on 2021 tax returns due in 2022. Although there are proposals to extend it, the expanded CTC is currently only available in 2021.

For Most Qualified Taxpayers, the ACTC is Automatic: Income-eligible parents who filed tax returns for 2019 or 2020 (whichever is the latest year that the IRS has on file) will receive ACTC payments automatically. For others, the IRS has a non-filer sign up tool on its website to report qualifying children born before 2021. This group includes low-income families who did not earn enough to have to file taxes. Payment Dates are Fixed: The six scheduled payment dates for ACTC benefits payable in 2021 are July 15, August 15, September 15, October 15, November 15, and December 15. Most payments will be made via direct deposit. The purpose of advance payments-versus simply getting the expanded tax credit via an income tax return next year is to get money in the hands of eligible families sooner for COVID-19 relief.

Payment Amounts are Fixed: Under current tax law, the "regular" child tax credit is $2,000 per eligible child age 16 and younger and $1,400 is refundable (i.e., a tax credit is larger than what people owe so they receive the difference as a refund). For 2021 only, the expanded CTC increases to $3,000 per child age 6 to 17 and $3,600 for children under age 6 and the credit is fully refundable. ACTC payment amounts from July through December 2021 are $250 per month (children age 6-17) and $300 per month (age 5 and younger).

There are Income Limits: Working families will receive a full expanded CTC if they earn an adjusted gross income (AGI) for the 2021 tax year up to $75,000 (single tax filers), $112,500 (head of household), and $150,000 (married couples filing jointly or MFJ). Above those amounts, the expanded CTC decreases by $50 for every $1,000 that earnings are higher, phasing out completely at about $20,000 over the limits (i.e., singles earning up to $95,000 and couples with combined earnings up to $170,000). Parents who earn over the phase-out caps can still take the regular CTC if they earn up to $200,000 for singles and $400,000 MFJ.

Useful Resources: The IRS recently unveiled its Child Tax Credit Update Portal to assist parents with questions about the expanded CTC and ACTC payments. At this portal, users can view their eligibility and advance payments and unenroll from receiving advance payments.

Taxpayers Could Be Overpaid: Because the IRS is using past tax year data for a current tax year credit, there will be some overpayments. For example, taxpayers who found a higher-paying job, got a pay raise or bonus, added a spouse to the labor force, or had investment capital gains or any other extra taxable income in 2021. They could find themselves over the income limits that are noted above. Unlike excess stimulus payments that were forgiven, ACTC overpayments will result in a smaller refund or an extra tax bill in 2022.

There is a "Safe Harbor" Rule: A "safe harbor" rule is a legal provision that reduces or eliminates some type of liability or penalty provided that certain conditions are met. Single taxpayers earning less than $40,000 and MFJ couples earning less than $60,000 (in 2021) who receive an ACTC overpayment will not need to repay the excess amount.

Divorce/Unmarried Parents Can Add Complications: Some divorced parents alternate the child tax credit between spouses with one spouse taking it in odd years and the other in even years. The

IRS, however, does not know this and will send ACTC payments to the spouse listed on the last tax return that it has on file. Divorced couples need to deal with this (as well as the increased payment available in 2021) based on the specifics of their financial agreements. Parents who have a child together and never married have similar decisions to consider.

The IRS is Contacting Eligible Taxpayers: The IRS is sending two letters to approximately 36 million eligible families, one to notify them about their eligibility for ACTC payments and the second to notify them of their estimated monthly payment. Conversely, taxpayers should notify the IRS immediately to update necessary information such as a change in address, bank account, or number of eligible children.

There are Several Good Reasons to Opt-Out: While ACTC payments are available in 2021, they are not required. Some taxpayers may want to opt out of advance payments and receive whatever expanded CTC they are due, if any, when they file their 2021 tax return in 2022. Good candidates for opting-out of ACTC payments now and waiting to "settle up" in 2022 are taxpayers in the following categories:

· Those who do not normally receive a refund and do not want to owe a larger amount than usual
· Those who are unsure of their total 2021 income (e.g., freelancers and potential job changers)
· Those who prefer one large tax refund payment versus a series of smaller monthly payments
· Those who will have a higher income in 2021 (for any reason) than they did in 2020 or 2019
· Those who use an online calculator, find they don't qualify, and expect to receive advance payments

There are Deadlines to Opt-Out: The deadline to opt-out (unenroll) to stop an upcoming ACTC payment is three days before the first Thursday of the following month. Thus, these deadline dates will vary each month. For the August 15 ACTC payment, the deadline to unenroll is Monday, August 2 since the first Thursday is August 5. Unenrollment from advance payments is done using the IRS portal and clicking on "Unenroll from Advance Payments."

Save Half "Just in Case" Estimating tax liability is always tricky, but never more so in times of economic turmoil such as what Americans have experienced in 2020-21. Family incomes and tax laws can change unexpectedly, making it difficult to stick to a plan. For this reason, many tax experts recommend a "save half, spend half" strategy for ACTC payments. In case your calculations are off, money will be set aside to pay taxes due next year. If it turns out you don't owe more to the IRS, you will have an additional windfall.