

IRS Begins Child Tax Credit Payments

The IRS recently began sending the first of six monthly payments comprising the prepayment of the 2021 Child Tax Credit. These payments are the result of the American Rescue Plan Act which made significant changes to the Child Tax Credit for tax year 2021.

Modifications to the Child Tax Credit

The three most significant changes to the Child Tax Credit – all three of which apply solely for tax year 2021 – are as follows:

1. The maximum credit has been increased and is different depending on the age of your children. If the modified AGI requirements are met, a taxpayer will receive a \$3,000 credit per qualifying dependent, age 17 or younger as of December 31, 2021. The maximum credit increases to \$3,600 per qualifying dependent if the child is under age 6 as of December 31, 2021.
2. The credit is fully refundable for tax year 2021, meaning that even if a taxpayer has no tax liability, they are eligible to receive the full Child Tax Credit. Previously, only 70% of the credit was potentially refundable.
3. The IRS will prepay 50% of a taxpayer's anticipated 2021 credit in 6 monthly installments, from July to December of 2021. The prepayment amount will be based on the taxpayer's 2020 tax return on file (or 2019 tax return, if 2020 is unfiled).

2021 Tax Return Filing: Potential Repayment

With regard to the monthly 2021 Child Tax Credit prepayments, it is important to realize that these payments will reduce the Child Tax Credit that is able to be claimed on the taxpayer's 2021 tax return, or, in some situations, the payments may even need to be paid back by the taxpayer when they file their 2021 tax return. This is in stark difference to the stimulus payments issued by the IRS in 2020 and 2021, where there was no mechanism in place to repay the excess payment amount.

In January 2022, the IRS will send a Letter 6419 showing the total amount of Child Tax Credit prepayment to all taxpayers who received such payments. The prepayment amount on this letter will first reduce the Child Tax Credit able to be claimed on the 2021 return. If the prepayments are in excess of the calculated Child Tax Credit based on 2021 filing status and income, the excess advance payment amount will be treated as an increase to income tax owed. Note that for taxpayers with lower modified AGI levels, there is repayment protection that will prevent any excess advance payment amount from increasing income tax owed.

Reasons for and Avoidance of Excess Advance Payment

An excess advance payment amount can happen for numerous reasons, including income being materially higher in 2021 than 2020, or a taxpayer claiming less qualifying dependents in 2021 than they did in 2020 (a common situation for divorced parents who may alternate claiming dependent children for tax purposes).

To avoid a situation where a taxpayer has a higher than expected 2021 tax liability, a taxpayer may unenroll in the monthly child credit payments using the IRS's online [Child Tax Credit Update Portal](#). Although it is too late to opt-out of the first monthly installment payment, the deadline to opt-out of the second payment is currently set at August 2, 2021. If a taxpayer's tax status is married filing jointly, their spouse also needs to unenroll since unenrolling only applies on an individual basis. If their spouse doesn't unenroll, the taxpayer will still receive half of the joint payment they were originally scheduled to receive.

Contact Us

Please reach out to your PKF O'Connor Davies' tax advisor with regard to any questions relating to the Child Tax Credit or contact:

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