

Larry's Tax Law

Eligibility for Federal Stimulus Benefits Appears to Be Benign, But When You Peel Away the Onion, a Major Flaw Appears

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Background

During the COVID-19 pandemic, the federal government enacted three major pieces of legislation to provide financial relief to individuals and families. The American Recovery Plan Act ("ARPA"), the most recent legislation, provides the third round of Economic Impact Payments ("EIPs"), also referred to as stimulus payments (and "recovery rebates" in the acts), to millions of Americans.

EIP I

As of March 2020, a taxpayer generally qualified for [the initial EIP \("EIP I"\)](#) if the taxpayer was a U.S. citizen or U.S. resident alien, was not claimed as a dependent of another taxpayer, and had a Social Security number valid for employment. EIP I (\$1,200 for individual taxpayers and \$2,400 for taxpayers filing a joint return with an additional \$500 for each qualifying child or dependent under 17 years old) was based on adjusted gross income ("AGI"). To be eligible for the full payment amount, a taxpayer's AGI could not exceed: \$150,000 if married and filing a joint return; \$112,500 if filing as head of household; or \$75,000 for eligible individuals using any other filing status. EIPs were reduced by five percent of the amount by which AGI exceeded the applicable threshold. In December of last year, legislation increased the AGI phase-out amount for a "surviving spouse" from \$75,000 to \$150,000.

EIP II

As of December 2020, a taxpayer generally qualified for [the second EIP \("EIP II"\)](#) if the taxpayer was a U.S. citizen or U.S. resident alien, was not claimed as a dependent of another taxpayer, and had a Social Security number valid for employment. EIP II (\$600 for individual taxpayers and \$1,200 for taxpayers filing a joint return with an additional \$600 for each qualifying child or dependent under 17 years old) was based on AGI. To be eligible for the full payment amount, a taxpayer's AGI could not exceed: \$150,000 if married and filing a joint return, or if a surviving spouse; \$112,500 if filing as head of household; or \$75,000 for eligible individuals using any other filing status. EIPs were reduced by five percent of the amount by which AGI exceeds the applicable threshold.

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EIP III

As of March 2021, a taxpayer generally qualified for the third EIP (“EIP III”) if the taxpayer was a U.S. citizen or U.S. resident alien, was not claimed as a dependent of another taxpayer, and had a Social Security number valid for employment. EIP III (\$1,400 for individual taxpayers and \$2,800 for taxpayers filing a joint return with an additional \$1,400 for each qualifying child or dependent of all ages, including children under 19, college-age students, and adults with disabilities) is based on AGI. To be eligible for the full payment amount, a taxpayer’s AGI cannot exceed: \$150,000 if married and filing a joint return, or if a surviving spouse; \$112,500 if filing as head of household; or \$75,000 for eligible individuals using any other filing status. Payments phase out for taxpayers married and filing a joint return (or for surviving spouses) with AGI between \$150,000 and \$160,000; \$112,500 and \$120,000 for taxpayers filing as head of household; and \$75,000 and \$80,000 for individuals. Interestingly, due to the different AGI limitations for EIP III, some taxpayers won’t be eligible for EIP III even if they received an EIP I or EIP II.

Ineligibility

Taxpayers are **not eligible** for any of the EIPs if the taxpayer (i) was claimed for the tax year as a dependent on another taxpayer’s return (e.g., a child who may be claimed on a parent’s return as a dependent, or a parent who may be claimed on an adult child’s return as a dependent), (ii) is a nonresident alien, or (iii) does not have a Social Security number that is valid for employment.

Major Legislative Flaw

EIP I, II and III seem to share a major flaw – eligibility is based upon AGI. That is not the proper measurement of eligibility.

These programs were designed for a worthy reason – to help U.S. taxpayers in need during the tumultuous economic times resulting from the COVID-19 pandemic. Using AGI as the indicator of need is, in some cases, a poor choice.

AGI is reported on IRS Form 1040, line 11. Likewise, tax-exempt interest is reported on IRS Form 1040, line 2a. Line 2a (tax-exempt interest) is not a component of AGI. Hence, EIP eligibility does not consider the existence of tax-exempt interest.

Illustrations

Consider the following illustrations:

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Illustration 1: Taxpayers are a successful retired married couple with no dependents. They are U.S. citizens and have valid Social Security numbers. On their joint IRS Form 1040, line 11, \$145,000 of AGI is reported. The couple's AGI is solely derived from taxable interest income and qualified dividends. On Line 2a, the married couple reports \$1,340,000 of tax-exempt interest. They are eligible for EIP I, II and III as they clearly meet the AGI requirement in each case. From EIP I, II and III, they receive a total of \$6,400 in stimulus payments (i.e., \$2,400, \$1,200 and \$2,800). Yet, they were not in need of the benefits.

Illustration 2: Same facts as Illustration 1, but the couple's AGI is \$198,000 and they have no tax-exempt income. They do not qualify for EIP I, II or III.

Conclusion

No one would debate that the impetus for the EIP programs – to provide economic assistance to taxpayers in need – was meritorious. The above illustrations, however, reveal a serious flaw in the legislation. The taxpayers in Illustration 1, albeit not average taxpayers, are clearly not an aberration. Many wealthy retired taxpayers are in a similar tax situation. They are clearly not in need, yet they qualify under EIP I, II and III for stimulus benefits. On the other hand, the taxpayers in Illustration 2, who clearly are on a lower economic footing (measured by annual total income) than the taxpayers in Illustration 1, do not qualify under EIP I, II or III. This major flaw should not have been missed by lawmakers. A more reasonable eligibility standard would be AGI plus tax-exempt income.

Tags: Adjusted Gross Income, American Recovery Plan Act (ARPA), Coronavirus, COVID-19, Economic Impact Payments (EIPs), eligibility, Form 1040, stimulus payments, Taxpayer