

## Woodland Tax Service

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We fix tax problems. Let us help you with yours!

# Kiddie Tax



## Kiddie Tax

“Kiddie Tax” is the term used for the tax on certain unearned income of children taxed at the parent’s rate instead of the child’s rate. Children typically are in a lower tax bracket than their parents and the Kiddie Tax was developed to prevent parents from lowering their tax liability by shifting investment income assets to their children.

### Tax Treatment of Child’s Unearned Income\*

Income Amount	On Child’s Return	On Parent’s Return
First \$1,100	Not taxed.	Not taxed.
Second \$1,100	Taxed at 10% (0% for capital gains and qualified dividends).	Taxed at 10%.
Amounts over \$2,200	Taxed at parent’s rate for ordinary income and/or capital gains.	Added to parent’s income as ordinary income, qualified dividends, or capital gain distributions.

\* For dependents with no earned income.

## Kiddie Tax General Rules

### Children Subject to Kiddie Tax

- Child’s unearned income (investment-type income) was more than \$2,200.
- At least one of the child’s parents was alive at the end of the tax year.
- The child meets one of the following age requirements:

Under Age 18	Kiddie Tax applies
Age 18	Kiddie tax applies unless the child’s earned income was more than half of his or her support.
Full-Time Students Ages 19–23	

Age is determined on January 1.\*

\* **January 1 birthdays.** Under Kiddie Tax rules, a child born on January 1 reaches that age at the end of the previous year. For example, a child born on January 1, 2005, reaches age 18 on December 31, 2022.

**Unearned income.** Unearned income is generally all income other than earned income. It includes investment-type income such as taxable interest, dividends, capital gains (including capital gain distributions), rents, royalties, taxable Social Security benefits, pension and annuity income, taxable scholarship and fellowship grants not reported on Form W-2, unemployment compensation, alimony, and unearned income received as the beneficiary of a trust. Unearned income includes amounts produced by assets the child obtained with earned income (such as interest on a savings account into which the child deposited wages).

**Nontaxable income.** Unearned income includes only amounts the child must include in gross income. Nontaxable unearned income, such as tax-exempt interest and the nontaxable part of Social Security and pension payments, is not included in gross income.

**Capital loss.** A child’s capital losses are taken into account in computing the child’s unearned income. Capital losses are first applied against capital gains. If the capital losses are more than the capital gains, the difference (up to \$3,000) is subtracted from the child’s interest, dividends, and other unearned income. Any difference over \$3,000 is carried to the next year.

**Income from property received as a gift.** A child’s unearned income includes all income produced by property belonging to the child. This is true even if the property was transferred to the child, regardless of when the property was transferred or purchased or who transferred it. A child’s unearned income includes income produced by property given as a gift to the child. This includes gifts to the child from grandparents or any other person and gifts made under the Uniform Gift to Minors Act.

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**Example:** Amanda, age 13, received the following income.

Dividends—\$1,000

Tax-exempt interest—\$100

Wages—\$2,100

Capital gains—\$300

Taxable interest—\$1,200

Capital losses—(\$200)

The dividends were qualified dividends on stock given to her by her grandparents.

Amanda's unearned income is \$2,300. This is the total of the dividends (\$1,000), taxable interest (\$1,200), and capital gains reduced by capital losses (\$300 - \$200 = \$100). Her wages are earned income because they are received for work actually performed. Her tax-exempt interest is not included because it is nontaxable.

**Trust income.** If a child is the beneficiary of a trust, distributions of taxable interest, dividends, capital gains, and other unearned income from the trust are unearned income to the child. However, taxable distributions from a qualified disability trust are considered earned income.

**Earned income.** Earned income includes wages, salaries, tips, and other payments for personal services performed including self-employment. For purposes of determining a dependent's standard deduction, earned income also includes any part of a scholarship or fellowship grant that the dependent must include in his or her gross income. Earned income also includes taxable distributions from a qualified disability trust.

**Support.** A child's support includes all amounts spent to provide the child with food, lodging, clothing, education, medical and dental care, recreation, transportation, and similar necessities.

## Child Files a Tax Return

For a child who must file a tax return, Form 8615, *Tax for Certain Children Who Have Unearned Income*, is used to calculate the child's tax and must be attached to the child's tax return.

A child whose tax is calculated on Form 8615 may be subject to the net investment income tax (NIIT). The NIIT is a 3.8% additional tax on the lesser of net investment income or the excess of the child's modified adjusted gross income (MAGI) over a threshold amount.

## Parent Includes Child's Income/Tax on Parent Return

The election to include a child's income/tax on a parent's tax return is still available. In order to make this election, the child's unearned income must be less than \$11,000 for the year among other qualifications.

The parent's election to include the child's income/tax on the parent return is computed on Form 8814, *Parents' Election to Report Child's Interest and Dividends*, which must be attached to the parent's tax return.

### Reasons to file a separate return for your child:

- Your child's investment income could reduce your Earned Income Credit.
- Deductions and credits limited or phased out by AGI (Child Tax Credit, Credit for Other Dependents, education credits, medical deductions, etc.) could be affected.
- The taxable portion of any Social Security benefits you receive may increase.
- Some deductions can only be taken on your child's return.
  - Higher standard deduction if your child is blind.
  - Your child's own itemized deductions.
  - Penalty on early withdrawal of your child's savings.
  - Your child's capital loss carryover.
- If your child has qualified dividends or capital gain distributions, tax is up to \$110 lower on his or her own return.
- Your child's tax-exempt interest from certain private activity bonds would not be included in your AMT calculation.
- The additional tax on your child's income would not increase your estimated tax requirements.

### Reasons to report your child's income on your return:

- No additional return is required for your child.
- No estimated taxes payments are required for your child.
- Your child's tax can be paid from your withholding.
- Your child's income is treated as your income for purposes of the investment interest expense deduction.

## Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 72.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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