



Kiddie Tax

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Kiddie Tax

“Kiddie tax” is the term used for the tax on certain unearned income of children. 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.

Prior law. Under prior tax law, certain unearned income of children subject to the kiddie tax was taxed at the parents’ tax rate and if a parent had more than one child subject to the kiddie tax, the net unearned income of all children was combined, and a single kiddie tax was calculated.

New tax law. For tax years 2018 through 2025, the parents’ tax rate is not considered. The new law simplifies the kiddie tax by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child.

Taxable income attributable to earned income is taxed according to an unmarried taxpayer’s brackets and rates. Taxable income attributable to net unearned income is taxed according to the brackets and rates applicable to trusts and estates, with respect to both ordinary income and income taxed at preferential rates. Thus, the child’s tax is unaffected by the tax situation of the child’s parent or the unearned income of any siblings.

Note: The new kiddie tax rules expire for tax years after 2025.

Trusts and Estates—Ordinary Income Tax Rates (2018)

\$0 – \$2,550	10%
\$2,551 – \$9,150	24%
\$9,151 – \$12,500	35%
\$12,501 and over	37%

The preferential tax rates for qualified dividends and capital gains also apply to the child subject to the kiddie tax using the rates applicable for trusts and estates.

Trusts and Estates—Long-Term Capital Gain and Qualified Dividends Tax Rates (2018)

\$0 – \$2,600	0%
\$2,601 – \$12,700	15%
\$12,701 and over	20%

Kiddie Tax General Rules

Children Subject to Kiddie Tax

- Child’s unearned income (investment-type income) was more than \$2,100.
- At least one of the child’s parents was alive at the end of the tax year.
- The child is required to file a tax return for the year.
- The child does not file a joint tax return for the year.
- The child meets one of the following age requirements:
 - Under Age 18..... Kiddie Tax applies.
 - Age 18..... Kiddie Tax applies unless the child provided more than half of his or her own support with earned income.
 - Full-Time Students... Kiddie Tax applies unless the child provided more than half of his or her own support with earned income.
 - Ages 19–23..... half of his or her own support with earned income.

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, 2001, reaches age 18 on December 31, 2018.

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



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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 figuring 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.

Example: *Amanda Black, 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.

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Earned income. Earned income includes wages, salaries, tips, and other payments for personal services performed. 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 figure the child's tax and must be attached to the child's tax return.

A child whose tax is figured 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

At this time until further guidance is issued, the election to include a child's income/tax on a parent's tax return is seemingly still available. In order to make this election, the child's unearned income must be less than \$10,500 for the year among other qualifications.

The parent's election to include the child's income/tax on the parent return is figured on a separate form which must be attached to the parent's tax return.

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 70½.
- 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.