

Kiddie Tax



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CERTIFIED PUBLIC ACCOUNTANTS

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 \$1,000	Not taxed.	Not taxed.
Second \$1,000	Taxed at 10% (0% for capital gains and qualified dividends).	Taxed at 10%.
Amounts over \$2,000	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

The Kiddie Tax rules apply when a child’s unearned income (investment income) is over \$2,000.

- If the child’s interest, dividends, and other unearned income total more than \$2,000, the amount over \$2,000 is taxed at the parent’s marginal tax rate if that rate is higher than the child’s.
- If the child’s interest and dividend income (including capital gain distributions) total less than \$10,000, the child’s parent may be able to elect to include that income on the parent’s return rather than file a return for the child.

For either rule to apply, the child must be required to file a return.

Unearned income. Unearned income includes taxable interest, ordinary 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 income (other than earned income) received as the beneficiary of a trust.

Earned income. Earned income includes wages, tips, and other payments for personal services performed. Earned income also includes taxable distributions from a qualified disability trust.

Example: Beth is 17. She earned \$4,000 wages and \$3,000 interest in 2014 for total income of \$7,000. Beth claims a standard deduction of \$4,350, leaving taxable income of \$2,650. Beth pays tax at her parent’s rate on \$1,000 (\$3,000 investment income minus \$2,000). She pays tax at her own rate on the remaining \$1,650 of her taxable income.

Children Subject to Kiddie Tax

- Child’s unearned income was more than \$2,000.
- 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

Age is determined on January 1, 2015.*

* **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, 1997, reaches age 18 on December 31, 2014.



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's income taxed at parent's rate. Part of a child's unearned income may be taxed at the parent's tax rate if the qualifications are met. The child's tax is figured on a separate form (Form 8615) that must be attached to the tax return.

A child whose tax is figured on Form 8615 may be subject to the Net Investment Income Tax (NIIT). NIIT is a 3.8% 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 on parent return. A parent may be able to avoid having to file a tax return for the child by including the child's income on the parent's tax return. A parent can elect to do this if all of the following conditions are met.

- At the end of the tax year the child was under age 19 or under age 24, if a full-time student,
- The child's interest and dividend income was less than \$10,000 for the tax year,
- The child had income only from interest and dividends, which includes Alaska Permanent Fund dividends and capital gain distributions,
- No estimated tax payments were made for the tax year, and no prior tax year's tax overpayment was applied to the current tax year, under the child's name and Social Security number,
- No federal income tax was withheld from the child's income under backup withholding,
- The child is required to file a return unless the parent makes this election,
- The child does not file a joint return for the tax year, and
- The parent is the parent qualified to make the election or files a joint return with the child's other parent.

The parent's election to include child's income on the parent return is figured on a separate form (Form 8814) that must be attached to the tax return.

A parent who elects to report a child's unearned income on his or her return may be subject to the NIIT. The parent must include the child's income in figuring MAGI and add the child's income to the parent's net investment income.

Reasons to File a Separate Return for the Child

- Parents qualify for the Earned Income Credit. The child's investment income can reduce the credit.
- Income over \$2,000 increases the parent's AGI. All deductions and credits limited or phased out by AGI are affected (Child Tax Credit, education credits, medical deductions, etc.).
- Taxable Social Security may increase.
- Some deductions can only be taken on the child's return.
 - Higher standard deduction for a child who is blind.
 - Child's itemized deductions.
 - Penalty on early withdrawal of child's savings.
 - Child's capital loss carryover.
- If the child has qualified dividends or capital gain distributions, tax is up to \$100 lower on the child's return.
- Child's tax-exempt interest from certain private activity bonds is included in the parent's AMT calculation.
- Child's tax increases parent's estimated tax requirements.

Reasons to Report Income on Parent's Return

- No return is required for the child.
- No estimated tax payments for the child.
- Child's tax can be paid from the parent's withholding.
- Some states that base tax on federal taxable income do not tax the second \$1,000 of the child's income.
- Child's income is treated as parent's income for purpose 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 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.

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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