Minors

**8541. What is the “kiddie tax”?**

This so-called “kiddie tax” prevents parents from shifting unearned income taxed at their higher rates to their children to be taxed at lower rates. So to prevent this type of income shifting, the kiddie tax subjects a child’s unearned income in excess of $2,000 to being taxed at the parents’ highest marginal tax rate.

For the kiddie tax to apply, at least one parent must be alive at the close of the taxable year. The parent whose taxable income is taken into account is (a) in the case of parents who are not married, the custodial parent of the child (determined by using the support test for the dependency exemption) and (b) in the case of married individuals filing separately, the individual with the greater taxable income.[[1]](#footnote-1) If the custodial parent files a joint return with a spouse who is not a parent of the child, the total joint income is applicable in determining the child’s rate.

 If there is an adjustment to the parent’s tax, the child’s resulting liability must also be recomputed. In the event of an underpayment, interest, but not penalties, will be assessed against the child.[[2]](#footnote-2)

The kiddie tax applies only to “net unearned income.” “Net unearned income” is defined as adjusted gross income that is not attributable to earned income, and that exceeds (1) the $1,000 standard deduction for a dependent child in 2014, *plus* (2) the greater of $1,000 or (if the child itemizes) the amount of allowable itemized deductions that are directly connected with the production of his unearned income.[[3]](#footnote-3) The source of the assets that produce unearned income need not be the child’s parents.[[4]](#footnote-4)

“Earned income” means all compensation for personal services actually rendered.[[5]](#footnote-5) A child is therefore taxed at his own rate on reasonable compensation for services that he or she performs.

Regulations specify that “unearned income” includes any Social Security or pension payments received by the child, income resulting from a gift under the Uniform Gifts to Minors Act, and interest on both earned and unearned income.[[6]](#footnote-6)

As to which children are subject to the kiddie tax, it applies to:

(1) a child under age 18; *or*

(2) a child age 18 whose earned income does not exceed one-half of his or her support; *or*

(3) a child age 19 to 23 who is a fulltime student with earned income that does not exceed one-half of his or her support.[[7]](#footnote-7)

Whether a child is under the threshold ages listed above is determined at the end of the tax year. “Child,” for purposes of the kiddie tax, includes children who are adopted, related by half-blood, or from a prior marriage of either spouse.[[8]](#footnote-8) The kiddie tax applies without regard to whether the child is considered a dependent for tax purposes.

 *Example:* In 2014, Pete is 16 with both parents alive. During 2014, Pete has $1,400 of interest income from a bank savings account and $1,700 he earned from a paper route. Some of the interest income is attributable to Pete’s paper route earnings that were deposited in the account. The balance of the interest was generated from cash gifts Pete received from his parents and grandparents. Pete has no itemized deductions and can be claimed as a dependent on his parent’s return.

Therefore, for the taxable year 2014, Pete’s standard deduction is $2,050, the amount of Pete’s earned income, $1,700 from the paper route, plus $350. Of this standard deduction amount, $1,000 is allocated against unearned income, and $1,050 is allocated against earned income.

Although some of Pete’s $1,400 of interest income is attributable to some of his paper route income deposited into his bank account, it is all treated as unearned income. Of that amount, $1,000 is taxed at Pete’s own tax rate (10%). The remaining taxable unearned income of $400 will be taxed at his parents’ highest marginal tax rate.

**8541.02 Can parents include the amount of their child’s unearned income subject to kiddie tax on their own income tax return?**

Under certain circumstances, parents may elect to include their child’s unearned income subject to the kiddie tax on their own income tax return, thus avoiding the necessity of the child filing a return. The election is available to parents whose child has gross income of more than $1,000 and less than $10,000 (in 2014), all of which is from interest and dividends.[[9]](#footnote-9) However, by doing so, the parents would increase their adjusted gross income and be subject to potential phase outs or other tax benefits that decrease as a result of certain threshold amounts of adjusted gross income.

The election is unavailable if there has been backup withholding under the child’s Social Security number or if estimated tax payments have been made in the name and Social Security number of the child.

1. . Temp. Treas. Reg. §1.1(i)-1T, A-11, A-12. [↑](#footnote-ref-1)
2. . Temp. Treas. Reg. §1.1(i)-1T, A-17, A-19. [↑](#footnote-ref-2)
3. . IRC Sec. 1(g)(4); Rev. Proc. 2013-35, 2013-47 IRB 537. [↑](#footnote-ref-3)
4. . Temp. Treas. Reg. §1.1(i)-1T, A-8. [↑](#footnote-ref-4)
5. . IRC Secs. 911(d)(2), 1(g)(4)(A)(i). [↑](#footnote-ref-5)
6. . Temp. Treas. Reg. §1.1(i)-1T, A-8, A-9, A-15. [↑](#footnote-ref-6)
7. . IRC Sec. 1(g)(2). [↑](#footnote-ref-7)
8. . Temp. Treas. Reg. §1.1(i)-1T, A-13, A-14. [↑](#footnote-ref-8)
9. . IRC Sec. 1(g)(7); Rev. Proc. 2008-66, 2008-45 IRB 107. [↑](#footnote-ref-9)