Family, Home, and Job: Avoid "Kiddie Tax"

Filing Guide

Use Form 8814 to report your child's unearned income on your return.
Report kiddie tax on Form 8615. You can attach it to your child's return or your own.
IRS Publication 929:
Tax Rules for Children and Dependents

Land Mines

Be sure to consider the effect that shifting investments to your children will have on college financial aid. Colleges generally expect you to use 35% of your child's assets towards the family contribution, but just 6% of your own.

The tax code has always included provisions to discourage parents from putting investments in their children's names to be taxed at their lower rates. Through 2017, the so-called "kiddie tax" applied to dependent children under 19 and dependent full-time students under age 24 who report unearned income over $2,100. The Tax Cuts and Jobs Act of 2017 turbocharged that penalty by subjecting such income to punitive trust and estate income rates. However, the SECURE Act, passed as part of the 2020 appropriations bill, restores the actual tax to the parents' marginal rate.

For 2024,

- If your dependent child's unearned (investment) income is under $1,250, they don't need to file a return.
- If your child's unearned income is more than $1,250, a return is required. Unearned income from $1,250 to $2,500 is taxed at the child's rate.
- If your child's unearned income exceeds $2,500, the kiddie tax kicks in. (If your child itemizes deductions and has more than $1,250 in deductible investment expenses, the floor is $1,250 plus the deductible investment expenses.)
- If you're married filing separately, use the larger separate taxable income to calculate the kiddie tax.
- If you're divorced, use the income of the parent who has custody for the greatest part of the year to calculate the tax.
- Your child's income doesn't increase your AGI for purposes of figuring limits on deductions or credits. For example, it won't keep you from contributing to a Roth IRA.

The kiddie tax rules crimp your ability to cut tax by shifting investment income to your children. But you can still save tax by shifting investment income up to the kiddie tax threshold into your child's name. And the new special dividend rates narrow the difference between your tax and theirs. You can also invest your child's assets in vehicles that don't generate current income:

- U.S. Savings Bonds that mature after the child is no longer subject to the tax. (That said, savings bonds avoid paying tax by paying next-to-nothing in interest.)
- Municipal bonds
- Education IRAs
- Section 529 plans
- Rental real estate, oil & gas, or equipment leasing programs using depreciation deductions to shelter income.

