



## The “Kiddie” Tax or How Children Are Taxed

Children are subject to income taxes just like their parents. However, there are some special rules that apply, and some of them can get complicated. This article provides some general information, but you may want to consult your tax advisor to better understand how your children are being taxed.

### **The General Rule**

Generally, children are treated as a separate taxpayer and their income is taxed at the same marginal rates as their parents. The tax table used to calculate their tax is the single filer table. The lowest rate is 10% and the rates rise to 35% (for 2010) for the highest levels of income.

### **Rules for 2010 Returns**

These rules will apply to children under the age of 18, 18 year olds with earned income less than half of their support, and 19 to 23 year old students with earned income less than half of their support

If a child has a job, their earned income is taxed regularly. In fact, the first \$5,700 is usually tax free (by taking advantage of the standard deduction). Then income is taxed at the child's marginal bracket, usually 10%. Even if the child has less than \$5,700 of earned income, a tax return may still be necessary to get a refund of any taxes that were withheld at their job.

If the child has unearned income from interest, dividends or capital gains, the rules get a bit more difficult. If the child meets any of the three criteria described above, the first \$950 of unearned income is not taxed and the next \$950 is taxed at the child's tax rate. All the unearned income above \$1900 is taxed to the child, but at the parent's tax rates.

This complication, known as the Kiddie Tax, was enacted to prevent families from shifting large amounts of investment income to children to avoid having it taxed at the parent's higher rates.

### **The Really Complicated Rules**

The interaction between the Kiddie Tax and the parents' tax situation can become very complicated if the parents have an unusual tax issue like the Alternative Minimum Tax or relatively large amounts of capital gains. In those cases, a qualified tax advisor is a must.