Kiddie Tax

The Kiddie Tax is a tax that a minor has to pay on unearned income, including investment income or other types of income. The Kiddie Tax was created in 1986 to prevent parents from transferring income-producing assets into a child's name to take advantage of the child's lower tax rate. Before 1986, parents could shelter their investment income from higher tax rates by holding assets in their minor children's names.

Under the Kiddie Tax, all unearned income above a certain threshold is taxed at the parent's marginal income tax rate instead of the child's tax rate. This tax applies to dependent children under the age of 18 at the end of the tax year (or full-time students younger than 24).

For 2022, the first $1,150 of a child's unearned income qualifies for the standard deduction, the next $1,150 is taxed at the child's marginal tax rate, and unearned income above $2,300 is taxed at the parent's marginal tax rate. In 2023, the limits rise to $1,250 and $2,500. A child's unearned income may include:

- Dividends
- Capital gains
- Taxable interest
- Taxable scholarships
- Income produced by gifts
- Income produced by custodial accounts (such as UTMA or UGMA accounts)

There are a couple of exceptions where the kiddie tax rule does not apply. For example, if a child has earned income that totals more than half the cost of their support, this is considered an exception. Additionally, if a child files a tax return as married filing jointly, this is also an exception.

You can legally minimize the amount of Kiddie Tax you owe. The easiest way is to keep your child's investment and unearned income below the $2,300 annual threshold. Choosing investments that do not pay interest or dividends is an effective way to avoid paying the Kiddie tax. Using a 529 plan to gift investments to your child allows you to help with qualified education expenses while avoiding the Kiddie Tax. Even using a Roth IRA can be a helpful way for your kids to save money since tax there is no tax liability upon distribution. A parent can also

consider investments that potentially generate tax-exempt income, such as municipal bonds. Regardless of what strategy you may utilize, it is essential to come up with a plan that best suits the child. Not having proper plans can financially impact you and your child.