

New “Kiddie Tax” Provisions Change Tax Planning

By Gary L. Maydew

Gary L. Maydew discusses how the new kiddie tax provisions change tax planning.

Spreading income among family members has long been one of the most effective family tax planning tools available to practitioners. The goal is to transfer income from high-income family members to family members who are in low-income brackets or, ideally, to relatives who are below the taxable income threshold.

History of Family Tax Planning

Congress, the IRS and the Courts, interested in protecting treasury revenues, have placed many limits on family tax planning. The assignment of income doctrine prevents transferring the tax obligation on income. If the income is generated from services, the income is taxed to the provider of the services.¹ Similarly, if the income is generated from property, the income is taxed to the owner of the property.² The metaphorical analogy, famous in tax practice, is that of the tree (the asset) and the fruit of the tree (the income). Just as the fruit of the tree belongs to the tree, so does the income belong (in terms of the responsibility to pay tax) to the owner of the property that produced the income.³

Making gifts of property (the “tree,” to continue the analogy) to children became more popular in the decades of the 50s, 60s, 70s and 80s as the combination of higher income and the bracket creep created by inflation put taxpayers in higher and higher tax brackets. Practitioners responded with innovative

income-shifting ideas such as interest-free loans to children. Congress largely shut the door on this tactic in the Deficit Reduction Act of 1984. Subject to some exceptions, the forgone interest on below-market loans to relatives is treated as if there were two hypothetical transactions:⁴

- A transfer of the forgone interest from the lender to the borrower (generally treated as a gift to both parties)
- A transfer back to the lender (treated as interest income to the lender (high-income parent) and as interest expense to the borrower (the low-income child))

Imposition of the “Kiddie Tax”

One of the goals of Congress, in passing the Tax Reform Act of 1986, was to lower tax rates and broaden the income base by eliminating various tax shelters. The “kiddie tax” was only one of many provisions aimed at high-income taxpayers. As originally passed, the Code provided for the child’s unearned income in excess of \$1,000 to be taxed at the parent’s rate.⁵ Children age 14 and older by the end of the tax year were not subject to the kiddie tax.⁶

Subsequent Changes to the Kiddie Tax

The changes made to the kiddie tax in tax bills passed in 1988, 1989, 1996, 1998, 2001 and 2004 were relatively minor. However, effective for 2006 and 2007, Congress broadened the scope of the kiddie tax by increasing the covered age from under age 14 to under age 18.⁷

Gary L. Maydew, Ph.D., CPA, is a Retired Accounting Professor at Iowa State University.

The New Rules

The latest broadening of the kiddie tax, effective for 2008, was included in the Small Business Work Opportunity Tax Act of 2007.⁸ A clue to the motivation of Congress in amending the kiddie tax is the placement of the changes in the kiddie tax, *i.e.*, under the heading “Revenue Provisions.” Congress was concerned by media reports in *THE WALL STREET JOURNAL* and other publications that wealthy parents were transferring considerable amounts of appreciated stock to their teenage children. The purpose of such transfers was to enable the children to take advantage of the zero tax rate on capital gains effective for 2008 through 2010. Taxpayers in any bracket below 25 percent are eligible for the zero rate on net capital gains.

Expansion of the Kiddie Tax to Older Children

Prior law continues to apply to children who have not reached age 18 by the end of the year. However, the Small Business Work Opportunity Tax Act of 2007 extended coverage of the kiddie tax to children who are either age 18 by the end of the year or to children who are ages 19 to 23 by the end of the tax year.⁹ These older children are subject to the kiddie tax only if all three situations below apply:¹⁰

- The child’s earned income does not exceed one-half of the child’s support (as defined in Code Sec. 911(d)(2)).
- Either parent of the child is alive at the close of the tax year.
- The child does not file a joint return for the tax year.

The broadened age rules are effective for tax years beginning after May 25, 2007 (effective in 2008 for calendar year taxpayers).

How the Kiddie Tax Works

Children who are subject to the kiddie tax pay tax at the greater of the tax that would apply to the child’s income if the kiddie tax provisions did not exist, or the sum of the tax that would be imposed by the kiddie tax rules if the taxable income of the child were to be reduced by the child’s “net unearned income, plus the child’s share of the “allocable parental tax.”¹¹

Net Unearned Income

For purposes of the kiddie tax, “net unearned income” is defined as the child’s unearned income, reduced by the sum of (1) the greater of the child’s standard deduction (\$900 in 2008) and adjusted for inflation,

or (2) the child’s itemized deductions directly connected to investment income, plus \$900 (in 2008), also adjusted for inflation.¹²

Allocable Parental Tax

The term “allocable parental tax” is relatively straightforward and intuitive. It is the tax on the parent’s taxable income, determined by including the net unearned income of all of the children who are subject to the kiddie tax, less the tax on the parent’s taxable income not including the children’s net unearned income.¹³

The word “allocable” is used because more than one child of the taxpayer could be subject to the kiddie tax. In that event, as discussed below, the total kiddie tax is allocated among the children.

Child’s Share of the Allocable Parental Tax

An individual child’s share of the allocable parental tax is determined by multiplying the total allocable parental tax by a ratio. The ratio is determined by dividing the individual child’s net unearned investment income by the total net investment income of all the taxpayer’s children who are subject to the kiddie tax.¹⁴ Only the children who have both taxable income and unearned income in excess of \$1,800 will enter into this calculation.

Example 1. Roger Rich and his wife Jenny have three dependent children, ages 11, 13 and 15, all with unearned income. Their unearned income in excess of \$1,800 for 2008 was as follows:

11-year old = \$ -0-
 13-year old = \$1,600
 15-year old = \$2,400

The allocable parental tax amounted to \$1,120. The 13-year old’s share was \$448 [$1,120 \times (\$1,600 / \$4,000)$]. The 15-year old’s share was \$672. Inclusion of the net unearned income of the children in computing the kiddie tax does not affect phase-outs, exclusions, deductions or credits of the parent’s tax return.¹⁵

Example 2. In 2008 D. Pendent, age 16, had \$6,000 of unearned income and no earned income. D’s parents are in the 35-percent tax bracket. Their tax without including her net unearned income is \$97,120. D has no itemized

deductions. Her net unearned income is \$4,200 (\$6,000 – \$900 – \$900). The parent's tax after including D's net unearned income is \$98,590 [\$97,120 + (\$4,200 × 0.35)]

The “Negative” Definition of Unearned Income

For purposes of the kiddie tax, the tax code defines unearned income in a negative sense, *i.e.* “the portion of the adjusted gross

income for the tax year which is not attributable to earned income ...”¹⁶

Earned income is as defined in Code Sec. 911(d)(2), *i.e.*, wages, salaries, or professional fees and

other amounts received as compensation for personal services actually rendered, including the fair market value of all noncash remuneration paid.¹⁷ If both personal services and capital are material income-producing factors, a reasonable amount, not to exceed 30 percent of the net profits of the business, is considered earned income.¹⁸ The net unearned income for a given year cannot exceed the individual's taxable income for that year.¹⁹

What Unearned Income Includes

Unearned income is investment-type income and as such includes interest, dividends and capital gains. Social security benefits and pensions paid to a child are, to the extent that they are includible in gross income, treated as unearned income for this purpose.²⁰ To the extent that unearned income of a trust is distributed to a beneficiary, it is treated in the hands of the beneficiary as unearned income for purposes of the kiddie tax. However, distributions from a qualified disability trust are considered earned income for purposes of the kiddie tax.²¹

Directly Connected Itemized Deductions

Directly connected itemized deductions are those expenses paid in order to produce or collect taxable income, or manage, conserve or maintain property that is held for income producing purposes.²² Included would be such expenses as custodian fees, service charges, service fees to collect taxable interest and dividends, and investment counseling fees.²³ These “directly connected” expenses are subject to the

two percent of AGI floor. They are added with other miscellaneous expenses that are subject to the two-percent floor.²⁴

Example 3. Bill Issue, age 13, had \$5,000 of interest and dividend income in 2008. His AGI was also \$5,000. He had investment counseling fees of \$1,230 and no other miscellaneous itemized deductions. His miscellaneous itemized deductions after deducting the two-

percent floor are \$1,130 (\$1,230 – (\$5,000 × 0.02)). Because this exceeds the \$900 standard deduction, his deductions to arrive at net unearned income total \$2,030 (\$1,130

+ \$900). Thus, his net investment income is \$2,970 (\$5,000 – \$2,030).

Tax Tip. Commissions on purchases and sales of securities must be treated as additions to basis or as an offset to the sales price. Thus, the commissions would not reduce net investment income. However, annual or other periodic fees charged by a brokerage firm would be deductible as directly connected expenses.

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Which Parent's Marginal Tax Rate Will Apply to the Child's Tax?

If the parents are married to each other and file jointly, the answer to the above question is obvious: The child's tax rate on the net unearned will be determined by the parent's joint return. But what if the parents are married but file separate returns, have never married, are divorced or legally separated, living under a temporary decree of separation, not legally separated but estranged, or remarried after death of a spouse? Each scenario is considered below.

Parents Are Married but File Separate Returns

If separate returns are filed, the return of the parent with the highest taxable income is used to determine the child's tax on its unearned net investment income.²⁵ Although filing joint returns usually saves a considerable amount of tax, there are situations where spouses benefit from using the married filing separately status. Such filing status may be advantageous if one spouse has large casualty losses or

medical expenses. In rare circumstances, even the two-percent floor on miscellaneous itemized deductions may result in the married filing separately status minimizing federal income taxes.

Parents Have Never Married

If the parents did not live together the entire tax year, the tax return of the parent who had custody of the child for a majority of the tax year is used to figure the child’s tax on the net unearned income.²⁶ However, if the parents did reside together all tax year, the parent with the highest taxable income is used.²⁷

Example 4. Jenny Split, age 17, has net unearned income of \$4,200 in 2008. She lived with both parents, Maggie Split and John Green until August 17, 2008, at which time John moved out of Maggie’s household. Jenny stayed with her mother. Maggie and John’s respective taxable incomes for 2008 without regard to inclusion of Jenny’s net unearned income are \$35,000, and \$48,000. Jenny’s net unearned income will be included with Maggie’s taxable income to determine the kiddie tax.

Example 5. Assume the same facts as in Example 4 except that Maggie and John did not split. Jenny’s net unearned income will be included with John’s taxable income to determine the kiddie tax.

Parents Are Divorced or Legally Separated and Custodial Parent Has Not Remarried

In the above scenario, the custodial parent’s taxable income is used.²⁸ The determination of whether an individual is married is made at the close of the tax year unless the spouse has died, in which case the date of death is the determination date.²⁹

The Tax Court follows state law to determine whether or not a couple are divorced or legally separated at the end of the year. Even an oral pronouncement of a divorce, where the written decree was not entered until the next year, was held to be effective at the end of the year for tax purposes.³⁰

Parents Are Divorced or Legally Separated and Custodial Parent Has Remarried

The interesting result here is that the stepparent is now treated as the other parent for purposes of the

kiddie tax. Thus, the noncustodial parent becomes a nonentity for this purpose. In the event that the custodial parent and the new spouse file separate returns, the return with the highest taxable income is used.³¹

Example 6. I.R. and D. Vorse obtained a divorce in 2006. I.R. got custody of their only child, Lenny. In 2007 I.R. married Martha. In 2008, Lenny, now age 16 and still living with his father

and stepmother, had net unearned income above \$1,800. In order to take advantage of some capital losses and casualty losses, I.R. and Martha file separate

returns. The taxable income of the three adults without regard to Lenny’s net investment income was as follows:

D. Vorse = \$75,000
I.R. Vorse = \$14,000
Martha Vorse = \$26,000

Because the stepmother (Martha) has higher taxable income than I.R., her return will be used to determine the tax on Lenny’s net unearned income

Parents Are Living Under a Temporary Decree of Divorce or Separation

Law in the state of residence of the estranged spouses determines whether or not they are considered married.³² Even though individuals may obtain a permanent divorce decree or separation after the end of the tax year, they will be treated as married for such tax year even if separated and living under an interlocutory (temporary) decree of divorce.³³ Theoretically, such taxpayers could file a joint return, as the mere fact that taxpayers have not lived together during the course of the tax year shall not prohibit them from making a joint return.³⁴ If, as is likely, a joint return is not filed, the rules discussed above for married taxpayers filing separately will apply.

Not Legally Separated but Estranged

As discussed above, couples who are not legally separated but estranged could file a joint return. If, as is true in many instances they chose to file separately, the rules for applying the kiddie tax are

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the same as discussed above for married taxpayers filing separately.

Remarried After Death of a Spouse

If a widow or widower remarries, the new spouse is treated as the child's other parent. Again the non-custodial parent drops out of the picture for kiddie tax purposes. Therefore, the rules are the same as discussed above under the section titled "Parents Are Divorced or Legally Separated; Custodial Parent Has Remarried."

Computing the Child's Tax

The amount and place to compute the child's income tax depends on whether the relevant parent elects to have the child's income included on their return. First it is assumed that the parent does not make such election. Then the election and its impact on determining the child's and parent's taxes will be discussed.

Parent Does Not Make an Election

If the parent does not make an election to include the child's income on his or her return, the child's income tax is computed on Form 8615, *Tax for Children Under Age 18 With Investment Income of More Than \$1,700*.³⁵ For compliance purposes the child is required to include the parent's TIN number (social security number, or federal ID for noncitizens) on Form 8615. Therefore, the parent is required by law to furnish such number to the child.³⁶ The child's tax is determined in three steps on Form 8615. The first two steps involve determining the child's net investment income and then determining the "tentative tax based on the tax rate of the parent," (the kiddie tax).

A portion of the child's investment income will be taxed at the parent's rates only if both of the below conditions are met: (1) the child has net unearned investment income (in 2008) of \$1,800 or more, and (2) the child has taxable income.

If one of the conditions is not met, Form 8615 should nonetheless be attached to the child's tax return. However, if both conditions are met, the smaller of the child's net investment income or taxable income is aggregated with the same computations for all children of the taxpayer who meet the age and net investment income conditions.

Example 7. In 2008 Alfred and Ally Affluent had taxable income of \$200,300, placing them at

the beginning of the 33-percent bracket. They have two children, both of whom are dependents of their parents; Allison, age 22 and a full-time student at State U, and David, age 18. Allison had unearned income of \$5,800 and no earned income. Because she has no earned income, her standard deduction is limited to \$900. David had earned income of \$3,000 and unearned income of \$2,800. Because David is a dependent, his standard deduction is limited to his earned income of \$3,000 plus an additional \$300, or \$3,300 in total. Allison's net unearned income is \$4,000 (\$5,800 – \$1,800). Her taxable income is \$4,900 (\$5,800 – \$900). David's net unearned income is \$1,000 (\$2,800 – \$1,800). His taxable income is \$2,500 (\$3,000 + \$2,800 – \$3,300). The taxable income that Alfred and Ally would report if their children's net unearned income were included is \$205,300 (\$200,300 + \$4,000 + \$1,000). Their hypothetical tax is shown in Table 1. The total kiddie tax for both children is the excess of the hypothetical tax over the tax on the Affluent's taxable income figured without including the children's net unearned income, or \$44,828. Thus, the total kiddie tax is \$1,650 (\$46,478 – \$44,828). Allison's share of the kiddie tax is \$1,320 (\$1,650 × (\$4,000/\$5,000)). David's share is \$330 (\$1,650 × (\$1,000/\$5,000)).

Table 1.

Tax on \$200,300	\$44,828
+ tax on \$5,000 @ .33	1,650
<u>Total</u>	<u>\$46,478</u>

The final step is to determine the child's total tax, *i.e.*, the sum of the kiddie tax and the child's tax on the income that is not taxed at the parent's rates. The child's total tax is computed as follows:

1. The net investment income is subtracted from the total taxable income to determine the portion of the taxable income that will be taxed at the child's rate.
2. The tax is figured on the amount derived in step 1.
3. The tax figured in step 2 is added to the child's share of the kiddie tax.
4. The tax on the child's taxable income, determined without considering the kiddie tax, is computed.

5. The child’s total tax is the greater of the amounts obtained in step 3 and step 4.

Example 8. Assume the same facts as in Example 7. The excess of David’s taxable income over his net investment income (step 1) is \$1,500 (\$2,500 – \$1,000). His tax on that amount (step 2) from the tax tables is \$101. The sum of that tax and David’s share of the kiddie tax (step 3) is \$431 (\$330 + 101). The tax on David’s total taxable income (step 4) from the tax tables, is \$251. Because the \$431 tax obtained in step 3 exceeds the \$251 tax obtained in step 4, David’s total tax is \$431.

Congress, the IRS and the Courts, interested in protecting treasury revenues, have placed many limits on family tax planning.

Parent Makes an Election to Include Child’s Net Unearned Income on the Parent’s Return

The kiddie tax, like so much of our tax laws instituted since the early 1960s, adds additional complexity to the taxpayer’s efforts at compliance. Congress, when it instituted the kiddie tax in Tax Reform Act of 1986, gave some consideration to this added complexity. In order to provide a little relief to taxpayers, Congress allowed parents in limited instances to elect to claim the unearned income of the child on the parent’s tax return.³⁷ Effective for the tax years 2008–2010, the election may be made if all of the following criteria are met:³⁸

- The child’s gross income is entirely from interest and dividends. Alaska Permanent Fund dividends count as dividends for this purpose.
- The child’s gross income is more than (in 2008) \$900, but less than 10 times that (\$9,000 in 2008).
- No estimated payments have been made under the child’s name and TIN, and no amount withheld under Code Sec. 3406 (the backup withholding provision).
- The parent of the child to whom the income is to be taxed makes the election described below to have the income included on his or her return.

If the above criteria are met, the parent includes the child’s income on his or her return. The child is deemed, for purposes of the kiddie tax, to have no

gross income and is therefore not required to file a return. If the relevant parent does make the election, Form 8814, *Parent’s Election to Report Child’s Interest and Dividends* is used. The parent includes in his or her gross income the net investment income (in 2008 the gross investment income less \$1,800) of each child to whom the election applies.³⁹

Tax Tip. Electing to fill out Form 8814 makes a significant change in the parent’s tax return. Because the child’s unearned income in ex-

cess of \$1,800 (in 2008) is included in the parent’s gross income, the parent’s AGI correspondingly increases. An increase in AGI can create a number of unfavorable tax results for a taxpayer. Among them, the phase-out of a number of deductions and credits such as personal exemptions and itemized deductions for high-income taxpayers; IRA contributions and the student loan interest deduction; and the child tax credit, education credit, child care credit and the EIC. Reduced amounts of deductions for certain expenditures for which the taxpayer must exceed a “floor” based on AGI. These include casualty and theft losses; medical expenses; and miscellaneous itemized deductions. The above list is intended to be illustrative rather than all-inclusive.

How Form 8814 Works

The first step is to determine the income of the child that is to be reported on the parent’s individual tax return. The total amount of income that the parent will report is simply the child’s net unearned income, *i.e.*, in 2008 the excess of the unearned income over \$1,800. Note, however, that if the child has unearned income in excess (in 2008) of \$9,000 that Form 8814 cannot be used (Form 8614 must then be filed). The complexity of the calculations on Form 8814 depends on whether or not the child has qualified dividends and/or capital gains distributions. Each scenario will be examined.

Child Has No Qualified Dividends or Capital Gain Distributions

If the child has no qualified dividends or capital gain distributions, *e.g.*, has only interest income and ordinary nonqualified dividends, the calculations are

easy and straightforward. The net investment income of the child is included on the parent's return on line 21 of Form 1040 (the "Other Income" line). The taxpayer enters "From 8814" in the space next to the line. Thus, the net unearned investment of the child becomes part of the parent's AGI.

The above computations report the net unearned income. The tax on the first (in 2008) \$1,800 of unearned income must also be determined and added to the tax of the parent. If only one Form 8814 is filled out (only one child for which the parent is eligible to make the election), then the additional tax (in 2008) is \$90 ($0.10 \times (\$1,800 - \$900)$). The additional tax is included on line 41 of Form 1040.

Example 9. Paul Mason is a single parent of his 23-year-old child Mary, who is a full-time student at Michigan State. Paul's AGI in 2008, without regard to Mary's income, is \$100,000. Mary's only income in 2008 is \$3,100 of taxable interest. Paul elects to report Mary's income on his return. Paul will include \$1,300 ($\$3,100 - \$1,800$) on his return. He will also add \$90 ($\900×0.10) to his tax on line 41 of his return.

Child Has Either Qualified Dividends or Capital Gain Distributions

The complexity that arises if the child has either qualified dividends or capital gain distributions from a mutual fund (capital gain dividends) is that both types of income may be taxed at lower rates on the parent's tax return than other income (e.g., taxable interest) that the child may have. Therefore, the IRS requires the qualified dividends and capital gain distributions to be allocated between the first \$1,800 (in 2008) of unearned income and the portion of the child's unearned income in excess of \$1,800. The portion of the qualified dividends and capital gain distributions that is excess of the \$1,800 must then be carried to the relevant schedules on the parent's return (i.e., Schedules B and D).

An additional complexity is created if the child has tax-exempt interest from certain private activity bonds. In that event, electing to do Form 8814 would also require an inclusion of the child's tax-exempt interest on the parent's alternative minimum tax (AMT) form.

Tax Tip. At least for 2008 returns, electing to fill out Form 8814 in the above scenario seems ill

advised. Instead Form 8615 should be filled out and a return for the child filed. In addition to the needless complexity that is created by making the Form 8814 election, more tax will result. Reason: Unless the child has taxable income above the 15-percent bracket (\$32,550 in 2008), the child would pay a zero rate on the first \$1,800 of qualified dividends and capital gain distributions. Other instances in which it may be preferable to do Form 8615 include the additional standard deduction for a blind child is lost; any penalty the child may have incurred on the early withdrawal of a savings certificate is lost; and the child's itemized deductions cannot be taken (they would need to exceed \$900 to be a factor).⁴⁰

Sunset Provisions of the Kiddie Tax

Practitioners will doubtless recall that key provisions of The Economic Growth and Tax Relief Act of 2001⁴¹ have a "sunset provision," in this instance expiring after the year 2010. Included in the sunset provisions is the currently low marginal income tax rate of 10 percent. Given the current make-up of Congress, it appears unlikely that the tax cuts in the 2001 Act will be extended. Therefore Code Sec. 1(g)(7), which provides for a 10-percent rate on the child's first \$1,800 unearned income in 2008, will likely also disappear over the tax horizon, replaced by a 15-percent or higher rate if Congress so chooses.

Other Aspects of the Kiddie Tax

The kiddie tax results in the child's return being heavily intertwined with not only the parent's return, but also the returns of siblings. Several of the more common problems stemming from this interrelationship are discussed below.

Amending Tax Returns of the Parent or the Child

The interrelated aspects of one child's kiddie tax with that of the parent(s) and sibling(s) mean that if one of the individuals amends a tax return, another individual may be required to do so. The need to adjust the gross income of a child requires recomputing the kiddie tax of the child's siblings as well as the child's tax. Similarly, when the parent's taxable income is adjusted, the amount of the child's kiddie tax must be recomputed.⁴² Such adjustments, if they result in additional tax also result in interest charges assigned; however, penalties for underpayment do not apply

to the individual whose tax increased because of a change in the other individual’s income.

Example 10. On his 2007 return, I.B. Forgetful inadvertently left off an ordinary, nonqualified distribution from a mutual fund in the amount of \$5,000. In 2008 he filed an amended return. The resulting increase in taxable income pushed Forgetful from the end of the 28-percent bracket into the 33-percent bracket. Barbie, his 17-year-old daughter, had \$3,000 of net investment income from interest in 2007 and filed Form 8615 for that year. Barbie will need to file an amended return for the year 2007 and pay the additional tax liability. She will be subject to interest on the underpayment, but no penalty. However, I.B. will be subject to both the interest and penalty for underpayment of tax.

If one may analogize income tax planning tactics to roads, family tax planning continues to be one of the main thoroughfares leading to the tax planning destination.

Parent Has a Different Tax Year

In rare circumstances the parent may have a different tax year than the child’s tax year (e.g., the parent is on a fiscal year). In that event, the rules for inclusion of the kiddie tax are the same as those of a partner in a partnership that has a different tax year than the partner. Form 8615 is prepared using the parent’s return for his or her tax year that ends inside the child’s tax year.⁴³

Example 11. John Abbot is on an October 31 fiscal year. His 18-year-old daughter Abbie files on a calendar year basis. Abbie has net unearned income in excess of \$1,800 in 2008 and therefore must file Form 8615. The kiddie tax for Abbie’s 2008 return will be based on John’s tax return for the year ending October 31, 2008.

Parent’s Tax Return Information Not Available at Filing Date of Child

Often the parent’s tax return information will not be available by April 15. Common causes are the lack of a K-1 or other information return or the parent’s inability to determine their Schedule C income. The child, on the other hand, may want to file without extensions if the child has earned income subject to withholding

and expects a refund. The child is allowed to file his or her return using a reasonable estimate. The IRS considers information from last year’s return to be a reasonable estimate.⁴⁴ The word “Estimated” should be put on the relevant line on Form 8615. Upon receiving the correct information, the child is required to file an amended return (Form 1040X).⁴⁵

Parent Reluctant to Provide Relevant Tax Information to Child

The IRS will, in certain instances, provide to the child or the child’s legal

representative information about a parent’s tax return that is necessary in order for the child to determine the kiddie tax. The request for information must contain all of the following:⁴⁶

- A statement that the request is to comply with Code Sec. 1(g) and that the child or the child’s legal representative has tried to obtain the information from the parent
- A copy of the child’s birth certificate or passport to prove the age of the child⁴⁷
- Evidence indicating that the child may have unearned income of more than \$1,800. Examples of acceptable evidence would be copies of Form 1099s for the current year or a copy of the child’s prior year tax return.
- The name, address and, if known, both the social security number and filing status of the parent
- If a legal representative of the child is making the request, a copy of their Power of Attorney or proof of legal guardianship

The IRS also makes the sensible suggestion that if the above request is necessary, it may be necessary to get an extension of time to file the return because “there may be a delay in getting the requested information.”⁴⁸

Tax Planning Considerations

The standard tax planning advice is to minimize the effect of the kiddie tax, either through the choice of investment income or deferring gifts until the child graduates from the kiddie tax, or a combination of both strategies. The goal is to produce income that is either:

- earned income (e.g., a salary to the child or earned income from a partnership share);

- exempt from federal income tax (e.g., municipal bond interest);
- not taxed until realized in a sale or exchange (e.g., appreciated securities); or
- the taxation of which is deferred until some event occurs (e.g., EE bonds or market discount bonds).

The raising of the age to which children are subject to the kiddie tax has obviously made the last two tax planning strategies more difficult to attain. For the 19- to 23-year-old students, getting their earned income above 50 percent of their support is especially important. Tax practitioners can and should be of considerable help to their clients here, both in devising strategies to enhance earned income and in helping the client understand what counts as support for this purpose (e.g., scholarships are not counted as support for this purpose).

Another interesting aspect of the application of the kiddie tax to 19- to 23-year-olds is the joint return

consideration. Children in that age bracket who file joint returns are not subject to the kiddie tax. However, it is often helpful for young people who marry during the tax year to file separate returns for their first married year so that a parent of the bride and a parent of the groom can still get to claim the dependency deduction. Tax professionals can help determine which saves more money for the family as a whole: avoiding the kiddie tax or getting an extra dependency deduction.

Conclusion

If one may analogize income tax planning tactics to roads, family tax planning continues to be one of the main thoroughfares leading to the tax planning destination. The tax practitioner who can assist clients in minimizing or totally avoiding the kiddie tax will get his or her clients further down that road.

ENDNOTES

¹ *Lucas v. Earl*, S Ct, 2 USTC ¶496, 281 US 111.

² *Helvering v. Horst*, DC-DC, 40-1 USTC ¶9269, *aff'd*, CA-DC, 41-2 USTC ¶9576, 122 F2d 41.

³ *Lucas*, *supra* note 1; *Eisner vs. Macomber*, S Ct, 1 USTC ¶32, 252 US 189.

⁴ Code Sec. 7872(a)-(c), as added by Act Sec. 172 of the Deficit Reduction Act of 1984 (P.L. 98-369).

⁵ Code Sec. 1(i), as added by Act Sec. 1411 of the Tax Reform Act of 1986 (P.L. 99-514).

⁶ *Id.*

⁷ See Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) (enacted in May 2006; however, changes in the kiddie tax were made retroactively effective for years beginning after December 31, 2005).

⁸ Small Business and Work Opportunity Tax Act (P.L. 110-28).

⁹ Act Sec. 8241(a) of P.L. 110-28, amending Code Sec. 1(g)(2).

¹⁰ *Id.*, adding new Code Sec. 1(g)(2)(A)(ii).

¹¹ Code Sec. 1(g)(1).

¹² Code Sec. 1(g)(4)(A).

¹³ Code Sec. 1(g)(3)(A).

¹⁴ Code Sec. 1(g)(3)(B).

¹⁵ Temporary Reg. §1.1(i)-1T, Q-21, A-21.

¹⁶ Code Sec. 1(g)(4)(A)(i).

¹⁷ Code Sec. 911(d)(2)(A); Reg. §1.911-3(b)(1).

¹⁸ Code Sec. 911(d)(2)(B); Reg. §1.911-3(b)(2).

¹⁹ Code Sec. 1(g)(4)(B).

²⁰ Temporary Reg. §1.1(i)-1T, Q-9, A-9.

²¹ Code Sec. 1(g)(4)(c).

²² Publication 929, *Tax Rules for Children and Dependents* (2007), at 12.

²³ *Id.*

²⁴ *Id.*

²⁵ Code Sec. 1(g)(5)(B).

²⁶ Code Sec. 1(g)(5)(A).

²⁷ *Supra* note 22, at 6.

²⁸ *Id.*

²⁹ Code Sec. 7703(a); Reg. §1.7703-1(a).

³⁰ *R.P. Petrocine*, 73 TCM 2619, Dec. 52,002(M), TC Memo. 1997-189.

³¹ *Supra* note 22, at 6.

³² Rev. Rul. 58-66, 1958-1 CB 60.

³³ Reg. §1.6013-4(a).

³⁴ *Id.*

³⁵ The 2008 form was not available as of the writing of this article. The \$1,700 amount will be changed to \$1,800. Given the other changes for 2008 (e.g., the extension to age

23 for students), it will be interesting to see how the IRS describes the new tax form. Will the new heading on the form have to have three lines of description?

³⁶ Code Sec. 1(g)(6).

³⁷ Act Sec. 1411 of P.L. 99-514, adding Code Sec. 1(i)(3). Note that several subsequent tax acts made various changes to the kiddie tax and also re-designated Code Sec. 1(i) as 1(g).

³⁸ Code Sec. 1(g)(7)(A).

³⁹ Code Sec. 1(g)(7)(B)(i).

⁴⁰ Instructions, Form 8814 (2007).

⁴¹ Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16).

⁴² Temporary Reg. §1.1(i)-1T, Q-17, 18, A-17, 18.

⁴³ Code Sec. 1(g)(3)(C).

⁴⁴ Announcement 88-70, IRB 1988-16, 37; *supra* note 21, at 10-11.

⁴⁵ *Supra* note 22, at 11.

⁴⁶ *Id.*

⁴⁷ Presumably the 2008 version of Publication 929 will also contain a requirement that those seeking information about a parent's return must also provide proof that the 19- to 23-year-old child is a full-time student.

⁴⁸ *Supra* note 22, at 11.

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