Re: 2023 Taxpayer Planning: Kiddie Tax

Dear Client,

Taxpayers with dependents who have unearned income during the year might want to consider some year-end tax planning strategies to reduce their overall tax burden. In addition, due to recent changes in the tax law, they may also have an opportunity to amend a prior year return.

The Tax Cuts and Jobs Act (TCJA) modified the “kiddie tax” to use the ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child after 2017. However, the Further Consolidated Appropriations Act, 2020 enacted in 2019, reverts the kiddie tax to the prior use of the parents' tax rate for tax years beginning after 2019. Therefore, for tax years beginning in 2020, the kiddie tax is calculated using the pre-TCJA rules where a child's unearned income is taxed at the parent's marginal tax rate. The Further Consolidated Appropriations Act also allows a taxpayer to retroactively apply the pre-TCJA rules to 2018, 2019, or both.

In general, a child is subject to the kiddie tax if:

- the child is required to file a tax return and he or she does not file a joint return for the year;
- the child's unearned or investment income is more than a threshold amount ($2,500 for 2023, $2,300 for 2022 and $2,200 for 2019, 2020 and 2021);
- either parent of the child is alive at the end of the year; and the child is:
  - under age 18 at the end of the tax year;
  - age 18 at the end of the tax year and does not provide more than one-half of his or her own support with earned income; or
  - at least age 19 and under age 24 at the end of the tax year, a full-time student, and does not provide more than one-half of his or her own support with earned income.

Under the rules prior to TCJA, the child's tax liability is equal to the greater of:

1. the tax on all of the child's income without regard to the rules for the kiddie tax; or
2. the sum of the tax on the child's total income reduced by net unearned income, plus the child's share of the allocable parent tax.

In some cases, a parent may elect to report a child's income on the parent's return. If a parent makes this election, the child is not required to file a return. If a parent makes the election to report a child's unearned income on the parent’s return, that income is treated as the parent's investment income for purposes of figuring the investment interest expense deduction. However, the parent may not claim an itemized deduction for the child's investment expenses. Moreover, there are other deductions that the parent may not take that the child could have taken on the child’s return. These include the standard deduction for a blind child, the deduction for a penalty on early withdrawal of the child's savings, and the itemized deduction for the child's charitable contributions.

Contact Us

It is important to review all the facts and circumstances of your situation in order to determine whether you should use the TCJA or the non-TCJA kiddie tax rules to amend your 2018 and 2019 tax returns to secure potential refunds. You might also consider if there is a benefit to reporting your child’s income on your return. We are here to assist you with your overall financial and family goals.

Sincerely,

EWK *Legal, Tax & Accounting Services*

For clients who have children with unearned income. (04/07/2023)