

New Factors for 2008 and Beyond Make Kiddie Tax Harder to Beat

As we mentioned earlier, for 2008 and beyond, your child can potentially get hit by the Kiddie Tax if he or she is under age 24 at year-end. But Congress made sure to complicate matters even more. There are actually three different age categories, and the Kiddie Tax rules are different for each one.

Under age 18 at year-end: If your child is 17 or younger on Dec. 31, the Kiddie Tax will apply if he or she has unearned income above the threshold for the year (probably \$1,800 for 2008) and positive taxable income after subtracting any applicable deductions. It makes no difference whether or not the kid is claimed as a dependent on your return. So in this age category, the rules are the same as for 2006 and 2007.

Age 18 at year-end: If your child is 18 at the end of the year and doesn't have earned income that exceeds half of his or her support the Kiddie Tax will apply if the child has unearned income above the threshold for the year and has positive taxable income after subtracting any deductions. Again, it makes no difference whether or not the kid is claimed as a dependent on your return.

Age 19 to 23 at year-end and a student: Let's say your child is somewhere between age 19 and 23 at year-end and is a student who doesn't have earned income that exceeds half of his or her support. The Kiddie Tax will apply if the child has unearned income above the threshold for the year and positive taxable income after subtracting for deductions. To be considered a student, the child must attend school full time during at least five months of the year. It makes no difference whether or not the kid is claimed as a dependent on your return. Bottom line: As ridiculous as it may seem, starting in 2008, some graduate students will be hit with the Kiddie Tax.

Here are some possible scenarios for 2008 and beyond.

Example 3: Over age 18 and not a student

Your unmarried daughter is 19 at the end of 2008 and isn't a student for the year. For 2008, she's exempt from the Kiddie Tax. Her unearned income for 2008 will be taxed at her lower rates.

Example 4: Over age 18 and a student

Your unmarried son is 23 at the end of 2008 and a graduate student for the year. He doesn't have earned income that exceeds half of his support. Therefore, he'll be hit by the Kiddie Tax if he has unearned income above the threshold and positive taxable income after subtracting any applicable deductions on his 2008 Form 1040.

Example 5: Year of graduation

Your unmarried daughter is 23 at the end of 2008. She's considered a student because she attends school full time during the first five months of the year before graduating in May. However, she starts a job in June and therefore has earned income in excess of 50% of her support for 2008. Thanks to that earned income, she's exempt from the Kiddie Tax for 2008, and all of her unearned income will be taxed at her lower rates.

Bottom Line

Even under the much stricter rules for 2008 and beyond, the Kiddie Tax can often be minimized or avoided by picking the right investments and by postponing some income and gains until years when the Kiddie Tax doesn't apply.

For example, tax-free interest from municipal bonds won't cause Kiddie Tax problems. Accumulated interest from Series EE U.S. Savings Bonds won't be hit with the Kiddie Tax if the bonds are cashed in when your child is Kiddie-Tax-exempt (say in the year of college graduation). The same goes if capital gains from your child's investments in growth stocks and tax-efficient mutual funds can be postponed until a Kiddie-Tax-exempt year. Life insurance products with investment accounts can also be used to dodge the Kiddie Tax. These are just a few ideas. Well-informed tax advisors can suggest additional Kiddie Tax avoidance strategies.

Finally, parents that use income-shifting to save money for their child's college education can generally avoid Kiddie Tax worries by using a Section 529 plan account or a Coverdell education [savings account](#)

to accumulate college funds. Given the stricter Kiddie Tax rules that take effect in 2008, these accounts are more attractive than ever.