

Kiddie Tax Age Limit Raised From Under 14 to Under 18

For parents thinking about trying to save taxes by transferring assets into their children's names, Congress has just thrown up another roadblock. In the recently enacted Tax Increase Prevention and Reconciliation Act, Congress raised the age at which the unearned income of minor children is taxed at the parents' tax rate from under age 14 to under age 18. Here are the details.

At one time, wealthy parents could significantly lower their family's tax bill by transferring investment assets to minor children. This tax technique, called income shifting, worked by taking income out of the parents' higher tax bracket and placing it in the lower tax brackets of their children. To curtail the use of this tax technique, Congress enacted the "kiddie tax" rules, which said that children under 14 who had more than a small amount of unearned (investment) income had to pay tax at their parents' marginal tax rate (the rate of tax on the last dollar earned). The threshold amount at which the kiddie tax kicks in is two times the amount allowed as a standard deduction for a dependent who has only investment income. For 2006, that amount is \$850, so the kiddie tax begins to apply when the child has more than \$1,700 in unearned income.

Under the new law, the age limit below which a child's income from investments is taxed at the parents' rate is raised from 14 to 18. The new law specifies, however, that the kiddie tax does not apply to a child who is married and files a joint return for the tax year. It also adds an exception to the kiddie tax for distributions from certain qualified disability trusts. The new provisions apply to tax years beginning after Dec. 31, 2005.