Bowles Rice

Kiddie Tax Changes Made in 2018 Repealed

The kiddie tax applies to any child who: (i) is under age 19 by the close of the tax year or is a full-time student under age 24; (ii) has at least one living parent at the close of the tax year; (iii) has unearned income of more than $2,200 (for 2019); and (iv) doesn't file a joint return. For children over age 17, the kiddie tax applies only to children whose earned income doesn't exceed one-half of their support.

Before enactment of the Tax Cuts and Jobs Act effective beginning in 2018, under the kiddie tax provisions, the net unearned income of a child was taxed at the parents' tax rates if the parents' tax rates were higher than the tax rates of the child.

The TCJA made changes so that, for tax years beginning after Dec. 31, 2017, the taxable income of a child attributable to net unearned income is taxed according to the brackets applicable to trusts and estates. Under pre-TCJA law, taxable income of a child attributable to earned income was taxed under the rates for single individuals.

Children to whom the kiddie tax rules apply and who have net unearned income also have a reduced exemption amount under the alternative minimum tax (AMT) rules.

Congress has expressed a concern that the TCJA changes unfairly increase the tax on certain children, including those who are receiving government payments (unearned income) because they are survivors of deceased military personnel ("Gold Star children"), first responders, and emergency medical workers.

The SECURE Act repeals the kiddie tax measures that were added by the TCJA. As a result, the unearned income of children is taxed under the pre-TCJA rules and not at trust/estate rates. Under the Act's version of the kiddie tax, a child will once again, beginning in 2020, be taxed at the parents' rates on net unearned income if higher than the child's rates.

This provision applies to all children who are subject to the kiddie tax, not just to Gold Star children. However, it will particularly benefit children who receive payments under the Survivor Benefits Plan (SBP), an insurance annuity provided by the Department of Defense. SBP payments are often assigned to a child by a surviving spouse who is receiving Dependency and Indemnity Compensation (DIC) from the Department of Veterans Affairs. This is done to avoid a rule that requires DIC paid to a spouse to be subtracted from the spouse s SBP payments.

SBP payments are taxable and are unearned income for kiddie tax purposes. Before the TCJA changes, the kiddie tax didn't take a large bite out of SBP payments, because the surviving parent usually wasn't in a high tax bracket. Under the TCJA, the child's net unearned income was taxed at trust and estate rates, which reached the top rate of 37% at taxable income over $12,500 for 2018. As a result, some Gold Star children who received SBP payments saw a sharp increase in their tax bill for 2018.

The Act also eliminates the reduced AMT exemption amount for children to whom the kiddie tax rules apply and who have net unearned income.

Special Election: Taxpayers can elect to apply this provision of the SECURE Act retroactively to tax years which begin in 2018, 2019, or both. To decide whether to make this election, taxpayers should compare the tax for 2018 under the TCJA rules with the tax under the pre-TCJA rules that were reinstated by the Act. Which set of rules provides the better result depends on the parent's marginal rate and the amount and type of the child's income. Taxpayers who have already filed for 2018 and who would benefit from the election should file an amended return.

The AMT exemption amount change applies to tax years beginning after Dec. 31, 2017.

Questions?

If you have any questions, please contact **David DeJarnett**, leader of the Bowles Rice Tax Team, at **(304) 264-4232**.