The New Kiddie Tax - Transcript

Tom Mullooly: In episode 99, we talk about kids and taxes.

Welcome to the Mullooly Asset Show. I'm your host Tom Mullooly, and this is episode number 99. Unbelievable. One of the things that we get asked all the time is, "Where do you get these topics to talk about?" We get feedback from our listeners to our podcast. We get questions from our viewers. We, in our conversations with clients, these kinds of things come up all the time. Tim, what are we going to be talking about in episode 99?

Tim: What's all this talk about a new Kiddie Tax?

Tom Mullooly: It's important to know what you're getting into before you start making transactions that may wind up costing you more money. Great article in the Wall Street Journal this week from Laura Saunders. Tim will put a link to it in the show notes, but this Wall Street Journal article talked about how the Kiddie Tax may not be all it's cracked up to be in the sense that you could wind up paying more money than you really expect.

The Kiddie Tax was actually created under TEFRA in 1986, so it's been on the books for 30 years, but prior to the changes that just happened in this year's tax bill, it was pretty easy and, in many cases, beneficial to transfer assets into a kid's name and/or grandson, granddaughter's name, let them take the capital gain, and then make a nice gift to the kids. The Kiddie Tax applies to everyone that's 18 and under and in many cases applies to kids that are 24. It doesn't apply if you're married. If you're a full time student, of course, up until 24 it counts. Things have changed, and you need to look before you leap. That's a phrase you're going to hear again in this video.

Let me give you some numbers. In 2015, the last numbers that we have from the IRS, 343,000 children in the United States paid this Kiddie Tax. They actually paid, if you collectively add them up, a billion dollars in taxes. Sounds like a lot doesn't it? Remember, it's 343,000 kids. When you do the math, that's about $2,900 per kid, so it sounds like a lot, but it's not. These are the kind of little things that really nickel and dime your way into a higher bracket or writing a bigger check to the IRS. With a couple of careful steps, you could avoid some of these things.

Here's the way it looks now under the new tax bill. If your child has income, income, up to $2,550, they're going to be charged a 10% tax rate. Prior to having an individual ... In prior years, under the old tax laws, if they their individual exemption, they could use that. Up to $2,550 of income taxed at 10%. From $2,551 and up, you're talking about tax rates that are similar to the rates you're going to find for trusts. The next rate is 24%. It goes up to 37% pretty quickly, so you may not want to have income for your child. Now if you have investments where there's long term capital gains or some dividend income, not all of it, up to $2,600 is these kind of returns, long term capital gains and some dividends, that's not taxed. It's zero percent tax bracket. Everything over $2,600 starts getting taxed at your capital gains tax rate. That's either going to be 15% or 20% for your long term gains. Remember, if you hold an asset for less than 12 months, it's going to be taxed as ordinary income or short term capital gain. Same rate.

Grandparents and parents, what they used to do, is they would take an asset that they've got a really good capital gain on, they would transfer it. Before they give a gift to their son or grandson, they would transfer it into their daughter or granddaughter's name, and then the kid would sell the stock, realize the gain, and then they would have a much, much lower tax bill. These generous grandparents and parents need to take a look. You've got to look before you leap. Before you take that action, do yourself a favor. Spend some time with a financial planner first and really learn the numbers before you pay unnecessary taxes. It just doesn't make sense. A little bit of planning can go a long, long way. You have to be super careful now about which investments you're choosing. Things like dividends ... If you own investments that throw off a lot of dividends that could wind up costing you a lot of money.

Good lesson for episode 99. Thanks for tuning in. Next one's going to be episode 100. Don't miss it.