

Money Matters

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Skloff Financial Group Question of the Month

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Q: Can our family avoid or save on taxes by shifting some of our assets from our accounts to our children's accounts?

The Problem – How the Kiddie Tax Can Be a Big Tax

To prevent parents from circumventing taxes by using their children as a tax shelter, the IRS has a tax on a child's investment and other unearned income – most commonly referred to as the “Kiddie Tax”.

The Solution – How to Avoid the Kiddie Tax Turning into a Big Tax

For 2024, a child can receive \$1,300 of unearned income on a tax free basis. The next \$1,300 is taxed at the child's 10% tax rate. All amounts in excess of \$2,600 are taxed at the parents' marginal income tax rate.

The Kiddie Tax applies to children under the age of 18 at the end of the tax year or to full-time students under the age of 24. Earned income includes wages and income from actively participating in a business. Unearned income includes interest, dividends, capital gains, rents and royalties. Let's examine some examples for 2024, where the parents are in the 35% marginal income tax bracket.

Parents and Child 1. Child 1 has \$500 of unearned income in the form of interest income from investments. Since it is less than \$1,300, none of it is taxed. See the table below.

Parents and Child 2. Child 2 has \$5,000 of unearned income in the form of interest income from investments. The first \$1,300 is tax free. The next \$1,300 is taxed at 10%, resulting in \$130 of taxes. The next \$2,400 (\$5,000 - \$1,300 - \$1,300) is taxed at 35%, resulting in \$840 of taxes. The total taxes are \$970. See the table below.

Parents and Child 3. Child 3 has \$50,000 of unearned income in the form of interest income from investments. The first \$1,300 is tax free. The next \$1,300 is taxed at 10%, resulting in \$130 of taxes. The next \$47,400 (\$50,000 - \$1,300 - \$1,300) is taxed at 35%, resulting in \$16,590 of taxes. The total taxes are \$16,720 – a big tax. See the table below.

2024 Kiddie Tax			
Calculation	Child 1	Child 2	Child 3
Unearned Income	\$500	\$5,000	\$50,000
Tax Free on First \$1,300	\$0	\$0	\$0
10% Tax on Next \$1,300	\$0	\$130	\$130
35% Tax on Remaining	\$0	\$840	\$16,590
Total Taxes	\$0	\$970	\$16,720

Conclusions

As seen in the examples above, shifting a limited amount of assets to your children can reduce your family tax responsibility, while shifting too many assets to your children can create a big tax.

Action Steps

Work closely with your Registered Investment Adviser (RIA) to reduce your taxes, and grow and preserve your wealth.

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