# AccountAbility

*A Quarterly Newsletter from PROFESSIONAL INCOME TAX SERVICE to our Clients and Associates*

*Summer 2007, Vol. 2, No. 3*


# UPDATE ON "KIDDIE TAX"

Hold onto your seat. You're in for an interesting ride, IF you are a parent and IF you have made—or intend to make—gifts of stock or other securities to your minor children in order to take advantage of the **lower** tax rate on children's investment income. Think again.

Just this May, the so-called "kiddie-tax" loophole was closed when President Bush signed new legislation.

## One Bad Apple...

What prompted Congress to close the loophole? In one word - reports. Reports that some taxpayers were transferring ownership of large amounts of stock, mutual-fund shares, and other assets to children in lower tax brackets as a tax-saving strategy. By extending the reach of the kiddie tax, Congress effectively eliminated many of the benefits of this strategy.

## Capital Gains

Under current law, the top tax rate on long-term capital gains and most corporate dividends is usually 15% and will remain at 15% through 2010. As a result, some investment advisers had suggested that high-income family members consider making gifts of appreciated securities to low-income family members (children) who could sell those securities TAX-FREE next year. How come? For taxpayers in the two lowest ordinary income brackets (10% & 15%), the current tax rate is only 5% and <u>reduces to zero (yes, 0!) next year.</u>

## 2007 versus 2008

Here's the breakdown under the CURRENT "kiddie-tax" law:

✪ Investment income above a certain level (usually $1,700 for 2007) for a child 17 years old or younger generally is subject to the parents' tax rates (assuming the parents' rates are higher than the child's).

Starting in 2008:

**1.** The age limit will increase from 17 to 18, or to **under** 24 IF the child is a full-time student.

**2.** Children with paid jobs will be exempt from this expanded provision IF (the magic word!) their earned income doesn't exceed one-half of the amount of their support. What does this mean? It simply follows the general rules for claiming a child as a "dependent" on tax returns.

**You can ONLY claim a dependent/child when you provide MORE than HALF of their support.**

## Downside to Gifts

Despite your good intentions, making sizable gifts to children could backfire IF they plan to attend college. If they apply for financial aid, they COULD be made ineligible for the aid.

## Options to Avoid "Kiddie Tax"

Parents might invest a child's money in the following:

✪ Growth-oriented stocks or mutual funds that produce little or no current income.

✪ Tax-exempt municipal bonds or municipal-bond funds.

✪ Land expected to appreciate in value.

✪ Closely-held family business stock that pays low or no cash dividends.

✪ U.S. Series EE savings bonds for which you can defer reporting interest income.

If you would like to discuss any of these options, please contact us.

## Where to go for more info:

✪ ***Our office***

✪ ***Our web site: protaxinc.com***

✪ ***IRS.gov***

✪ ***Savingforcollege.com for info on 529 plans as an alternative tax-savings strategy to the kiddie tax. (See pg. 2).***

✪ ***Congress' Joint Committee on Taxation web site -- house.gov/jct. Here you'll find a summary of the provisions of the new law and a table showing the estimated revenue impact.***


**PRO TAX INC**

*One State Road*
*Media, PA 19063*

*contact*
***Joseph Hare, CPA***

*610.566.1165*
*Fax 610.892.9833*
*jhare@protaxinc.com*
*www.protaxinc.com*

*Visa, MasterCard, AMEX, & Discover*