Kiddie Tax Overview for 2006

Part or all of a child's investment income may be taxed at the parent's rate rather than the child's rate. Because a parent's taxable income is usually higher than a child's income, the parent's top tax rate will often be higher as well.

This special method of figuring the federal income tax only applies to children who are under the age of 18. For 2006, it applies if the child's total investment income for the year was more than $1,700. Investment income includes interest, dividends, capital gains, and other unearned income.

To figure the child's tax using this method, fill out Form 8615, Tax for Children Under Age 18 With Investment Income of More Than $1,700, and attach it to the child's federal income tax return.

Alternatively, a parent can, in many cases, choose to report the child's investment income on the parent's own tax return. Generally speaking, this option is available if the child's income consists entirely of interest and dividends (including capital gain distributions) and the amount received is less than $8,500. However, choosing this option may reduce certain credits or deductions that parents may claim.

These special tax rules do not apply to investment income received by children who are age 18 and over. In addition, wages and other earned income received by a child of any age are taxed at the child's normal rate.

More information can be found in IRS Publication 929, Tax Rules for Children and Dependents.