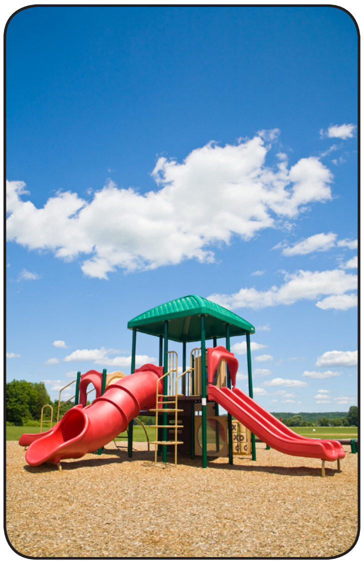

Children

Tax and Business Update

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UGMA/UTMA Accounts

- Assets transferred to minors are usually held in custodial accounts under the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA).
- Income earned on these accounts is taxable to the child.
- Generally, the child has full access to the funds when he reaches the age of majority, which varies by state (usually 18 or 21).

Diagram of UGMA/UTMA

Parent transfers (gifts) asset to child

↓

Asset held in UGMA/UTMA custodial account

↓

Income from account is taxable to child—subject to kiddie tax rules

↓

Custodianship terminates at age of majority—18 or 21 depending on state law

Kiddie Tax Rules

Under the “kiddie tax” rules, the unearned (generally, investment) income of children under age 18 and many children under age 19 (under age 24 if a full-time student) is taxed at their parents’ tax rate to the extent it exceeds certain thresholds (see *Tax Treatment of Dependent Child’s Income* on the next page).

Two ways to minimize the kiddie tax are to invest in assets that:

1) Defer income recognition until child is no longer subject to the kiddie tax or
2) Generate tax-exempt income.

Who Is Subject to the Kiddie Tax Rules?

Age	Rules apply if:
< 18	Always apply[1]
18	Child’s earned income ≤ 50% of support[1]
19–23	Child’s earned income ≤ 50% of support *and* full-time student[1]
> 23	Never apply

[1] *Exception:* If married and files a joint return or does not have at least one living parent, not subject to kiddie tax rules.

Municipal bonds: These debt obligations of various government entities generate interest that is not subject to federal income tax. However, their interest rate is normally lower than taxable bonds of similar quality and safety.

U. S. savings bonds: These bonds are issued at a discount (paper Series EE) or at face value (Series I and electronic series EE) and the interest is paid and taxed when they are redeemed. While the interest rate is low, these bonds have very low credit risk and the interest is exempt from state and local taxation. In addition, Series I bonds include an inflation-protection feature.

Growth-oriented investments: Certain stocks, mutual funds and real estate investments generate little or no current income that is subject to the kiddie tax. Instead, they appreciate in value until sold (presumably, when the child is no longer subject to the kiddie tax).

Caution: Mutual funds realize capital gains when changes are made in their portfolios. The timing of a fund’s capital gain distributions will be beyond the parents’ control, so a child may receive distributions that are subject to the kiddie tax.

Tax Treatment of Dependent Child's Income			
2016		**2017**	
Subject to Kiddie Tax Rules	*Not Subject to Kiddie Tax Rules*	*Subject to Kiddie Tax Rules*	*Not Subject to Kiddie Tax Rules*
Standard deduction: Greater of (1) $1,050 or (2) earned income plus $350 (not to exceed $6,300[1]) *Personal exemption:* $0		*Standard deduction:* Greater of (1) $1,050 or (2) earned income plus $350 (not to exceed $6,350[1]) *Personal exemption:* $0	
Earned Income Only[2]			
$0–6,300....................Not taxed Over $6,300............Child's rate		$0–6,350................. Not taxed Over $6,350..........Child's rate	
Unearned Income Only[2]			
$0–1,050.....................Not taxed $1,051–2,100........... Child's rate Over $2,100..........Parent's rate[3]	$0–1,050.....................Not taxed Over $1,050 .... Child's rate	$0–1,050.....................Not taxed $1,051–2,100........... Child's rate Over $2,100..........Parent's rate[3]	$0–1,050.....................Not taxed Over $1,050 .... Child's rate
Both Earned and Unearned Income[2]			
Unearned income: $0–1,050....................Not taxed $1,051–2,100 .... Child's rate Over $2,100.........Parent's rate[3] *Earned income:* Earned income *minus* remaining amount of standard deduction .... Child's rate	Total income *minus* the standard deduction .... Child's rate	*Unearned income:* $0–1,050....................Not taxed $1,051–2,100 .... Child's rate Over $2,100.........Parent's rate[3] *Earned income:* Earned income *minus* remaining amount of standard deduction .... Child's rate	Total income *minus* the standard deduction .... Child's rate

[1] Plus $1,550 if blind.

[2] Assumes standard deduction exceeds itemized deductions. If itemized deductions are greater, less income may be subject to tax.

[3] The child's rate applies, if higher.

IRA for a Child

- Reasons for funding a child's IRA:
  1) Shelter income from taxes.
  2) Establish a long-running retirement fund.
- Contribution limit for 2016 and 2017 is $5,500 (earned income, if less).

Example: Eve, age 15, has $2,000 of earned income so she makes a $2,000 IRA contribution. Eve retires 50 years later at age 65. Assuming the account earned 7% per year, the balance in year 50 based solely on the single $2,000 contribution would be $58,914. If the account earned 10% annually, the balance in year 50 would be $234,782.

If Eve contributes $2,000 a year for the next four years (and none after that) and earns 7% or 10% annually thereafter, the balances when she reaches age 65 are as follows.

	Annual Return	
Total IRA contributions	**7%**	**10%**
($2,000 in years 1–4).....................	$ 8,000	$ 8,000
IRA balance (year 50)...................	$213,523	$818,649

The handout is designed to provide accurate information regarding the subject matter covered. However, before completing any significant transactions based on the information contained herein, please contact us for advice on how the information applies in your specific situation.

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