Kiddie Tax and Taxable Scholarships

Background Information – updated for 2023

<u>Taxable Scholarship Income</u> (PUB 4012, Page J-1 and Chart B, Page A-2)

See PUB 970, Tax Benefits for Education, for additional information including allowed methods to convert a scholarship or fellowship grant (scholarship) into taxable scholarship for the purpose of maximizing American Opportunity Credit (AOC).

A scholarship is tax free only to the extent:

- It does not exceed qualified education expenses;
- It isn't specifically designated or earmarked for other purposes (such as room and board) and doesn't require that it can't be used for qualified education expenses; and
- It is not payment for teaching, research or other services as a condition for receiving it.

Taxable scholarships are considered as **earned** income for the purpose of determining if a dependent must file a tax return and for calculation of the Standard Deduction.

Taxable scholarships not reported on form W-2 are considered to be **unearned** income for the purpose of calculating Kiddie Tax, earned income credit and additional child tax credit.

<u>Who Must File</u> (PUB 4012, Chart B, Page A-2)

Children and Other Dependents: Single – Under 65 – not blind:
You must file a return if **<u>any</u>** of the following apply:

1. Your unearned income was over $1150
2. Your earned income (includes taxable scholarship) was over $13,850
3. Your gross income was more than the larger of

a. $1,150, or
b. Your earned income (up to $13,450) plus $400.

<u>Standard Deduction for Dependents</u> (PUB 4012 Page F-2)
The below method assumes the dependent is single, under age 65 and not blind.
See PUB 4012 for additional details.

1	Enter Earned Income (include taxable scholarships)	
2	Additional Amount	$400
3	Add line 1 and 2	
4	Minimum Standard Deduction	$1150
5	Enter the larger of line 3 or 4	
6	Amount for single filing status	$13,850
7	Standard Deduction is smaller of line 5 or 6	

<u>Affordable Care Act Considerations</u> - Anytime a dependent has a filing requirement, you must include the dependent's income in the household income on the parent's return. This will potentially lower the Premium Tax Credit.

These rules apply to a “child” whether or not the “child” is a dependent – applicability is detailed below.

The Kiddie Tax applies when **all** of the following requirements are met:

1. The child’s unearned income (including taxable scholarship) was more that the threshold ($2300 for 2023). If the threshold is exceeded, only unearned income in excess of the threshold is hit with the higher Kiddie Tax.
2. The child is required to file a return for the tax year.
3. The child was either:
    a. Under 18 at the end of the year, or
    b. Age 18 at the end of the year and did not have earned income that was more than half of their support*, (support does not include amounts received as scholarships), or
    c. A full time student at least age 19 and under age 24 at the end of the tax year and did not have earned income that was more than half of their support* (support does not include amounts received as scholarships).
4. At least one of the child’s parents is alive at the end of the tax year.
5. The child does not file a joint return for the tax year.

    * One of the rules to be a “qualifying child” is the child cannot provide more than half of their support (except for EIC).

    PUB 929, Tax Rules for Children and Dependents, Figure 2 has a flow chart that details the above requirements and may be easier to follow – see the last page.

How to avoid the Kiddie Tax

In order to avoid the Kiddie Tax, the child must **not** meet **any one** of the above requirements. At the time of the tax return, there is little that can be done other than when manipulating qualified educational expenses and taxable scholarships to maximize the American Opportunity Credit. Due to the different ways that taxable scholarship is treated, the option is either one of the following:

- keeping under the filing threshold of $13,850 for earned income (including taxable scholarship).
- keeping under the Kiddie Tax unearned income threshold of 2300 (including taxable scholarship)

One will need to determine all the earned and unearned income sources for the child and then determine the limiting situation when manipulating qualified educational expenses to maximize the American Opportunity Credit while avoiding the out-of-scope Kiddie Tax. If it makes a significant difference, the other option is to assist the child with a Free File option from the IRS website.

Figure 2. Does Your Child Have To Use Form 8615 To Figure Their Tax?