

Teens and Taxes

Does a Teenager Owe Taxes?

Presented by Carol Topp, CPA
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Common Misconceptions

Teenagers don't owe taxes
He makes too little to owe taxes
She's just babysitting
The IRS doesn't know because he's paid in cash
Parents can put teen's earnings on their tax return

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Types of Income

Earned: Employee (W-2) or independent contractor (1099 MISC)

Unearned: Interest, dividends, capital gains

Self-Employed: Profit from your own business (Schedule C)

Self Employed Tax (SE Tax) is the equivalent of both halves of Social Security & Medicare taxes (15.3%)

Household Employee: Work at someone's home like a babysitter, mowing lawns

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Income Tax Thresholds

If teen has EARNED income over \$5,450 (in 2008), they owe Federal Income tax.

If teen has UNEARNED income over \$800, they owe Federal Income tax

If teen as SELF-EMPLOYMENT income over \$400, they owe Self-Employment tax (SE Tax) and Federal Income Tax

If teen was a HOUSEHOLD EMPLOYEE, they do not owe SS & Medicare (if under age 18) but may owe Federal Income tax

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Both Earned and Unearned Income

If Total EARNED and UNEARNED income is greater than the larger of

\$900 or

EARNED income plus **\$300**,

they owe Federal Income tax.

If (EARNED INCOME + UNEARNED INCOME) > Pick the larger
\$900

or

(EARNED INCOME + \$300)

then they owe Federal Income Tax.

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Example of Earned and Unearned Income

Sam worked at Papa John's and earned \$1,000. He also had interest and dividends of \$400 on his college savings fund.

EARNED INCOME = \$1,000

UNEARNED INCOME = \$400

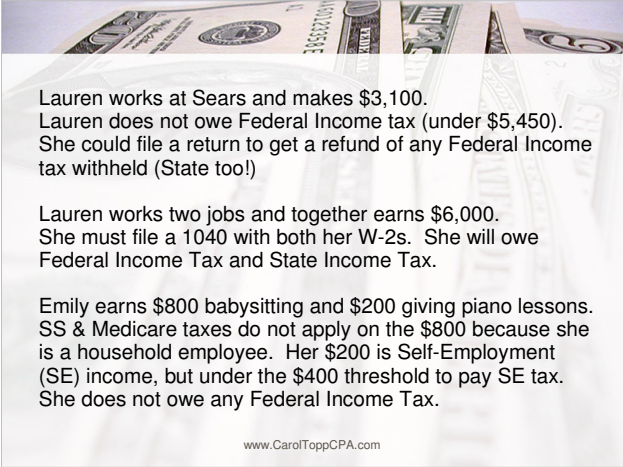
TEST:

(\$1000 + \$400) > Larger of \$900 OR (\$1000 + \$300)

\$1400 > \$1300

TRUE, so Sam owes Federal Income tax

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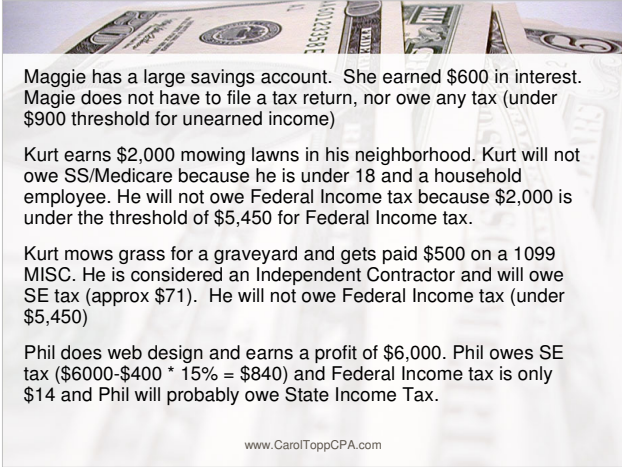


Lauren works at Sears and makes \$3,100. Lauren does not owe Federal Income tax (under \$5,450). She could file a return to get a refund of any Federal Income tax withheld (State too!)

Lauren works two jobs and together earns \$6,000. She must file a 1040 with both her W-2s. She will owe Federal Income Tax and State Income Tax.

Emily earns \$800 babysitting and \$200 giving piano lessons. SS & Medicare taxes do not apply on the \$800 because she is a household employee. Her \$200 is Self-Employment (SE) income, but under the \$400 threshold to pay SE tax. She does not owe any Federal Income Tax.

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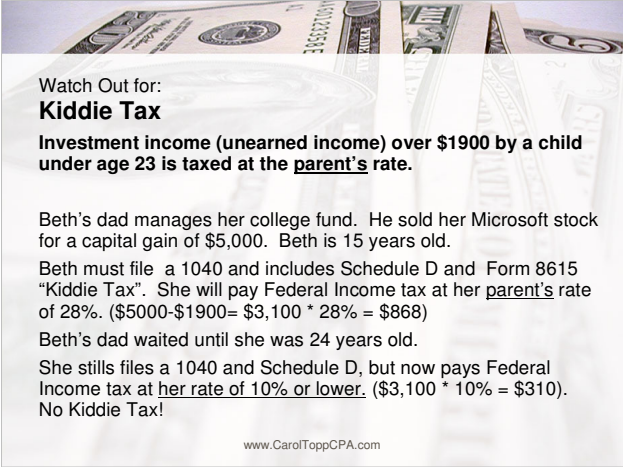
Maggie has a large savings account. She earned \$600 in interest. Maggie does not have to file a tax return, nor owe any tax (under \$900 threshold for unearned income)

Kurt earns \$2,000 mowing lawns in his neighborhood. Kurt will not owe SS/Medicare because he is under 18 and a household employee. He will not owe Federal Income tax because \$2,000 is under the threshold of \$5,450 for Federal Income tax.

Kurt mows grass for a graveyard and gets paid \$500 on a 1099 MISC. He is considered an Independent Contractor and will owe SE tax (approx \$71). He will not owe Federal Income tax (under \$5,450)

Phil does web design and earns a profit of \$6,000. Phil owes SE tax ($\$6000 - \$400 * 15\% = \$840$) and Federal Income tax is only \$14 and Phil will probably owe State Income Tax.

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Watch Out for:
Kiddie Tax

Investment income (unearned income) over \$1900 by a child under age 23 is taxed at the parent's rate.

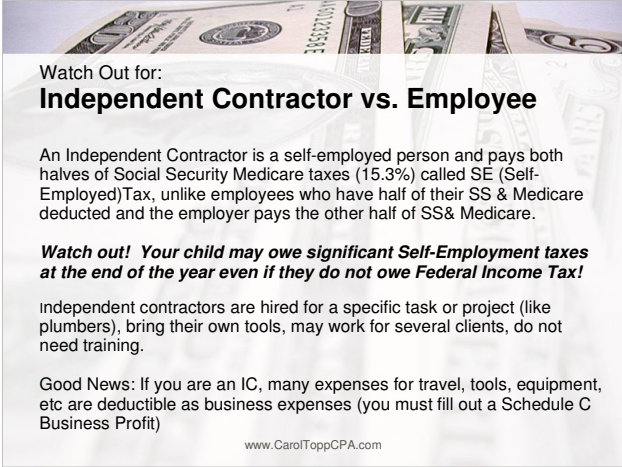
Beth's dad manages her college fund. He sold her Microsoft stock for a capital gain of \$5,000. Beth is 15 years old.

Beth must file a 1040 and includes Schedule D and Form 8615 "Kiddie Tax". She will pay Federal Income tax at her parent's rate of 28%. ($\$5000 - \$1900 = \$3,100 * 28\% = \868)

Beth's dad waited until she was 24 years old.

She stills files a 1040 and Schedule D, but now pays Federal Income tax at her rate of 10% or lower. ($\$3,100 * 10\% = \310). No Kiddie Tax!

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Watch Out for:

Independent Contractor vs. Employee

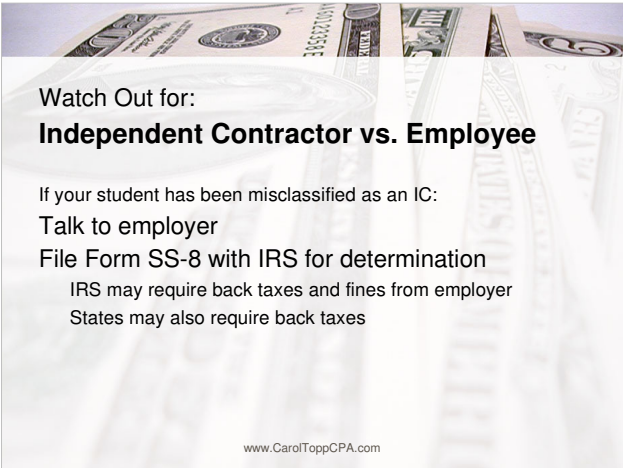
An Independent Contractor is a self-employed person and pays both halves of Social Security Medicare taxes (15.3%) called SE (Self-Employed) Tax, unlike employees who have half of their SS & Medicare deducted and the employer pays the other half of SS& Medicare.

Watch out! Your child may owe significant Self-Employment taxes at the end of the year even if they do not owe Federal Income Tax!

Independent contractors are hired for a specific task or project (like plumbers), bring their own tools, may work for several clients, do not need training.

Good News: If you are an IC, many expenses for travel, tools, equipment, etc are deductible as business expenses (you must fill out a Schedule C Business Profit)

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Watch Out for:

Independent Contractor vs. Employee

If your student has been misclassified as an IC:

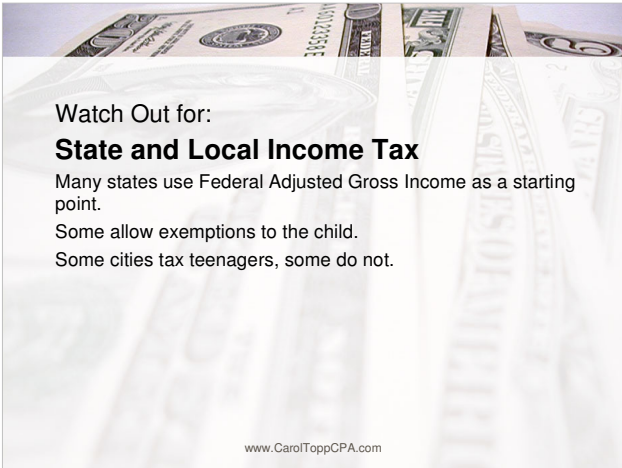
Talk to employer

File Form SS-8 with IRS for determination

IRS may require back taxes and fines from employer

States may also require back taxes

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Watch Out for:

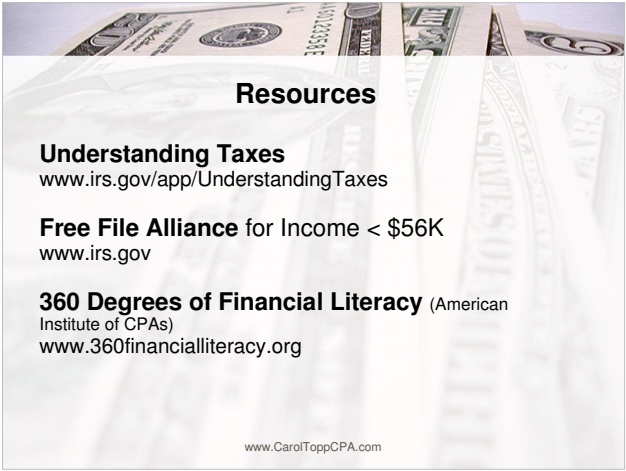
State and Local Income Tax

Many states use Federal Adjusted Gross Income as a starting point.

Some allow exemptions to the child.

Some cities tax teenagers, some do not.

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Resources

Understanding Taxes

www.irs.gov/app/UnderstandingTaxes

Free File Alliance for Income < \$56K

www.irs.gov

360 Degrees of Financial Literacy (American Institute of CPAs)

www.360financialliteracy.org