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This Issue:
Kiddie Tax Changes for 2008 - What To Do in 2007 & Beyond
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For most families, college is a large financial expense. Recent changes in the tax laws may affect your college savings if you are using accounts such as the Uniform Gift to Minors (UGMA) or the Uniform Transfer to Minors (UTMA). These "custodial" accounts allowed parents to take advantage of their children's lower tax bracket and provided large tax savings. However, within the last two years, the Prevention and Reconciliation Act of 2006 and the Small Business and Work Opportunity Tax Act of 2007 have brought multiple changes to the "kiddie tax" rules.

The so-called "kiddie tax" limits the amount of investment income a child can have before the income is taxed at their parents' tax rate - currently that limit is $1,700. The first $850 of the child's investment income is tax-free; the second $850 is taxed at the child's tax rate. Anything over $1,700 will be taxed at the parents' rate.

Are all children created equal? Not in terms of the kiddie tax. Prior to 2006 a child, in terms of the kiddie tax, was under 14. After the 2006 legislation, a child was considered to be anyone under the age of 18. Now with the 2007 legislation, effective 01.01.08, the question of who qualifies as a child will become more complicated then just age. The new age is under 19, but if the child is a full-time student, then that age jumps to under 24.

There are some conditions that can exclude children under the age of 24, such as if they provide half of their support through their earned income. Needless to say, all of these changes make custodial accounts far less attractive then they once were.

What to do in 2007? Real planning opportunities exist for those children between 18 and 23 who have, or have potential, investment income, over $1,700. Since under the current kiddie tax 18 to 23 year olds are not affected by the kiddie tax, but may be in 2008, you could realize investment income before 12.31.07. If an 18 to 23 year old currently had gains on any investments, these investments could be sold before 12.31.07 and then be taxed at their own tax rate before potentially being subjected to their parents' rate after 01.01.08.

Remember, those 19 or over who are not full-time students or qualify for an exception are not consider children in terms of the kiddie tax as of 01.01.08

What to do in 2007 and beyond? Consider investing and saving money for college in a 529 Plan. The assets in the Plan are considered parental assets and will be used in calculating the "expected family contribution". However, having the assets characterized as parental assets results in a more favorable treatment for financial aid than if the assets were held in the student's name. If you have an existing UGMA or an UTMA, you can roll that money over into a custodial 529 Plan. These funds will, however, be considered the child's, but will avoid the kiddie tax.

As with any investment, be aware of management fees as some 529 Plans have higher fees than others. For more information on 529 Plans please visit www.savingforcollege.com

If you have any questions or concerns regarding 529 Plans or how you may be impacted by the changing kiddie tax law, please do not hesitate to contact us.

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