Tax Tips You Can Use, July 2006

Children who Earn Income

By Kathleen Crawford, EA

Now that summer is here, many teenagers are working at their first summer jobs. Teenagers who earn money at their own jobs can create a tax consequence for their parents. This article discusses the effects of a child's income on her parents' income tax return.

Parents normally claim their children as dependents on their tax return. Many people think that claiming children is automatic, but it is not. For any dependent to be claimed, five tests must be met. Each test has rules, qualifiers and exceptions because this is, of course, our tax law. The tests are too complex to discuss in detail in this short article, but your teenage child meets the first three tests if he or she is unmarried, a US citizen, your child and lives with you for the entire year.

The last two tests involve income. The fourth test is the amount of income the teenager receives during the year. If your teenager is 18 or younger on December 31, then this income test does not apply. The last test is the tricky one. It is called the support test. That test says that you can only claim a dependent if you provide more than 50% of the dependent's support during the year. Items included in support are the expenses for food, lodging, clothing, recreation, transportation, medical care, and other necessities. Expenses that are directly spent on the dependent are counted directly, for example, school clothes, or dental work. Monies that are spent on the entire household, such as food and utilities, are divided by the number of people in the household. Money saved is not counted as part of support, only the money actually spent.

Now that your teenager is working, is the money that the teenager earns spent or saved? If it is spent, it is considered money spent on support of the person. If the teenager earns and spends too much, she could become ineligible to be a dependent on the parents' tax return. Let me give you an example. Your daughter is 16 and has her first job because she wants to buy a car. After doing all of the support calculations, you, the parent, find that you spend $6000.00 per year on her support. Your daughter finds a great job and earns $7000.00 and spends it all on clothes and her car. Her total "support" for the year is $13000.00. You only contributed $6000.00. That is less than 50%, so she cannot be a dependent on your tax return. That could make a big difference in the your tax liability and credits.

Now let us say that your daughter earns $7000.00 but only spends $2000.00 on clothes and saves $5000.00 for her car or college. In this example, her total 'support' is $8000.00 and your $6000.00 is much more than 50%. The $5000.00 saved does not count as support.

A good way to avoid failing the support test is to have a matching program. Instead of your child spending her earnings while you save for her college expenses, have your child save her earnings for college while you match her savings with spending money from you. It is important to be aware that claiming a child as a dependent is not automatic. As your child begins to contribute to her own support, you must provide more than 50% of her support to claim her as a dependent on your tax return.

The fine print is that this article is for information only. Please call Kathy or a tax professional for questions about your individual tax situation. The Jacksonville Tax Lady can be reached at 541-899-7926 or at 610 North Fifth Street.