

Tax Rules for Dependent Children

by Steve Smith

Military taxpayers often approach me with questions about how to handle their children's taxes. This article provides answers to their most frequently-asked questions.

Many service members who marry foreigners ask how they can obtain an Individual Taxpayer Identification Number (ITIN) for their German step-children, so they can claim them as dependents. The short answer is, they can't. The IRS won't issue an ITIN for someone who can't be claimed as a dependent, and in order to claim a dependency exemption the child must be a citizen or resident alien of the U.S., Canada, or Mexico. Germany is none of the above. Parents get pretty upset about this, and protest that "I've got the child's dependent ID card right here!" Just because someone is a military dependent does not make them a dependent for tax purposes.

I'm often asked if a child who worked in the summer hire program needs to file a tax return. The answer is usually no. Single taxpayers who are claimed as a dependent on their parents' return and who made less than \$5,800 in earned income, or less than \$950 in unearned (*e.g.*, investment) income, in 2011 have no obligation to file a federal income tax return. [Note: these threshold amounts change every year, so always look for the chart in the front of the instructions for Form 1040 "for children and other dependents" to see who must file.]

Just because a dependent doesn't have to file a tax return doesn't mean they shouldn't. If they had federal income tax withheld from their earnings, the only way to get it back is to file a return and claim a refund.

Summer hires are U.S. Government employees, and are therefore ineligible for the Foreign Earned Income Exclusion. The situation is different for dependents who work as baggers at the Commissary. They are not DECA employees, and do not receive a W-2. They work for tips. If they made more than \$5,800 in tips in 2011, they are technically required to file a return, but since they are eligible for the Foreign Earned Income Exclusion, they would most likely wind up paying no tax on their earnings. That's why most of them never even file.

Things get more complicated when children have investment income (*e.g.*, interest, dividends, and capital gains distributions) which is reported on 1099 forms bearing the child's social security number. Under certain conditions, parents can elect to report a child's interest and dividend income on the parents' return, using Form 8814. However, there is a cautionary note at the top of Form 8814 that warns parents that the tax on the child's investment income might be less if they were to file a separate return for the child, rather than include the investment income of the child on the parents' return.

If the child has investment income of more than \$1,900, a separate return must be filed for the child with Form 8615 attached. This method normally results in the child's investment income being taxed at the parents' tax rate, which is usually higher.

This is a complicated area, and parents who have questions about the issues addressed above should download a copy of IRS Publication 929, entitled "Tax Rules for Children and Dependents," from the IRS website at: <http://www.irs.gov/pub/irs-pdf/p929.pdf>

