TaxUpdate

★ ★ ★ ★ SPECIAL EDITION

LEVERAGING THE TAX CODE TO BUILD CHILDREN'S WEALTH

***The tax code is filled with incentives** that can help reduce the cost of raising children while creating opportunities to build wealth for their future. These strategies can provide significant savings and give the next generation a financial head start – but only if you know they exist. Use this guide to expand your understanding of these opportunities AND discover one or two ideas you can put to work for your family's benefit. Please call if you wish to explore your options.*

The Basic Tax Breaks

The best place to start is with a quick review of the tax breaks most families see on their tax return each year for children and dependents. These benefits are designed to help reduce the cost of raising a child. Take a minute or two to review them and make sure you are claiming every tax savings available.

- **Child Tax Credit.** This credit can reduce your tax bill by up to $2,200 for each qualifying child under age 17. The credit begins to phase out for higher-income taxpayers at $400,000 for married couples, $200,000 for everyone else.
- **Child and Dependent Care Credit.** When you use daycare or preschool so you and your spouse can work or look for work you may qualify for up to a $1,050 credit for one child, or $2,100 for two or more children.

This potential benefit can also be provided by your employer!

- **Earned Income Tax Credit.** This credit provides additional tax savings for lower- and moderate-income workers. Families with qualifying children can receive up to $8,231. You may qualify even if you owe little or no federal income tax.
- **Adoption Credit.** Get up to a $17,670 tax break when adopting a child. Eligible costs include adoption fees, court costs, attorney fees, and travel expenses.
- **Head of Household filing status.** You can decrease your taxable income by $24,150 if you're unmarried and provide more than half the cost of maintaining a home for a qualifying child or dependent.
- **Credit for Other Dependents.** This credit provides a $500 tax break if your child doesn't qualify for the Child Tax Credit. This usually happens with older children, college students, elderly parents, or other qualifying dependents.

Now that you have the basics, read on. This is where tax planning and wealth building ideas for children can be found.

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The $1 Million Idea

There is no minimum age for opening a Roth account... you only need to have earned income.

Remember this tax law, as it can help your child build a fund for a richer future.

- **STEP 1: Create earned income.** This could be mowing lawns, babysitting, dog walking, pet sitting and more. Even income from a lemonade stand is earned income.
- **STEP 2: Record the earned income.** Document the earned income. A Form W-2 is best, but a notebook and bank deposits can also support their earnings.
- **STEP 3: Open a Roth IRA.** A parent or grandparent opens the account as custodian, then contributes to the child's Roth IRA on behalf of a child with earned income. Consider matching your child's earnings with gifts so they can keep their lawn mowing money while still funding the Roth.
- **STEP 4: Invest and grow.** Contribute the maximum allowed or the child's total earned income, whichever is less. The 2026 contribution limit is $7,500.
- **STEP 5: Understand the rules.** Roth contributions are made with after-tax dollars (not a problem for most kids since their earnings are usually too low to be taxed). Earnings withdrawn before age 59½ are generally subject to tax and an early withdrawal penalty. However, contributions can always be withdrawn tax-free because the tax has already been paid.

Over time, this practice can build a Roth IRA that is in excess of $1 million dollars and will be tax-free for your child in their retirement years.

Anyone Can Fund a Tax-Advantaged Education

The tax code includes several ways to help offset the rising cost of education, but one strategy deserves special attention. Here's what you need to know.

Basic tax break mechanisms

Two of the most popular ways to fund school are the the American Opportunity Tax Credit, providing up to $2,500 per student for the first four years of college, while the Lifetime Learning Credit offers up to $2,000 annually with no limit on the number of years claimed.

The big one

But the one with the greatest potential to grow in value as a tax benefit over time is the 529 program because of its ever-expanding rules. Here is why it deserves your attention:

- Virtually **any adult** can set up an account for **any potential student**.
- **Anyone can contribute to the plan,** so multiple people can contribute to a single plan for a single child!
- **One beneficiary (child) can have multiple 529 plans.** For instance, one set up by parents, one by grandparents, and one by a friend of the family!
- **The annual contribution limit is generous,** up to the annual gift tax limit in 2026 of $19,000 ($38,000 for a couple). This is per contributor, not per beneficiary (student).
- **There's no tax on the earnings** from investments in the account if they're used to pay for qualified educational expenses.
- **You can superfund it** by donating 5 years of gifts all in one year.
- **Funds can be used** to pay for K-thru-12 education as well as college costs.

The details

Contributions are made with after-tax dollars. Earnings in the account grow the balance over time. As long as the funds are used to pay for qualified educational expenses, there is no tax on the earnings. Unused funds can be transferred to another child, rolled over into a retirement account or withdrawn. If withdrawn, earnings are taxed as ordinary income along with a 10% penalty.

If this is an opportunity for you, open the account while the child is young to maximize its growth potential. Because these plans are sponsored by individual states, compare your options carefully, as not all plans offer the same benefits.

Money to Build a Better Future for Kids

It's not every day the government and private philanthropists encourage families to build wealth for the next generation. But this is exactly what's happening with the new Trump Accounts beginning this year. Eligible children can receive free contributions from the federal government, and some may qualify for additional gifts from private donors both now and in the future. Here are several ways your family can take advantage of this opportunity.

- **Get a $1,000 head start.** Children born between 1/1/2025, and 12/31/2028, are eligible for a $1,000 federal contribution to a Trump Account.
- **You can contribute.** Family members may contribute up to $5,000 per year to help grow the account. Contributions are invested under program rules, and the money must remain in the account until the child reaches age 18.
- **Employers can help too.** Employers may contribute up to $2,500 per year for an employee's eligible child, so check to see if your employer is planning to add this benefit.
- **Private donors are joining the effort.** Michael and Susan Dell have pledged $250 for up to 25 million qualifying children ages 10 and younger who live in ZIP codes with a median family income below $150,000. Other philanthropists and organizations have also announced plans to support eligible children through the program.

  Only one account is allowed per eligible child, so be sure everyone agrees on who will open it. And remember to watch for announcements about additional matching programs and philanthropic contributions. More organizations may choose to participate as the program expands.

Leveraging Gifts Into Tax Savings

This idea combines three different tax rules – gift giving, capital gains, and the kiddie tax, to help children make full use of the tax code:

- *You can gift $19,000 ($38,000 per couple) in cash or other assets such as investments.*
- *Long-term capital gains are tax-free for single filers with taxable income up to $49,450 in 2026.*
- *The first $1,350 of a child's unearned income (interest, dividends, etc.) is tax-free; the next $1,350 is taxed at the child's typically lower tax rate.*

Here's how to use this information to your advantage.

STEP 1: Gift appreciated investments to a child. Keep it under the gift limit. Because minors cannot own stocks directly, you will need to open a UGMA (Uniform Gifts to Minors Act) or UTMA (Uniform Transfers to Minors Act) account on their behalf. The investment's original cost basis transfers to the child without triggering tax on the gift. Future dividends may also be taxed at the child's lower rate, creating an additional tax benefit.

STEP 2: Harvest unearned income each year but keep it under the kiddie tax threshold so there is little or no tax.

STEP 3: Let the investments grow over time.

STEP 4: As a young adult, when they are no longer a dependent, you can then take advantage of the lower, long-term capital gains tax rate. But only sell investments each year that can leverage the 0% tax rate. This money could then be used to pay for a wedding, a home, or future education.

It's a great technique to use for grandparents to help build the financial future of their grandchildren all while leveraging the tax code.

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This publication provides summary information regarding the subject matter at the time of printing. Please call with any questions on how this information may impact your situation.

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