

# Do Teenagers Owe Taxes?

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The United States federal government income tax system is complex and so naturally there is no simple answer to this question: do teenagers owe taxes? There are so many ways that a teenager can make money today. They can have a part-time job or even several jobs. They can be self-employed like my daughter who is giving piano lessons. They can be what the IRS calls a “household employee” doing babysitting or mowing grass. Sometimes they are not employees but independent contractors like my local newspaper carrier. Some teenagers have “unearned income” from savings accounts or investments in their name.

Here are some guidelines (based on 2007 amounts) to help you determine if a teenager may owe taxes.

- If a teenager has EARNED income over \$5,350 (in 2007), they owe federal income tax. Earned income is money from a job where the worker gets a W-2 (as an employee) or 1099MISC (as an independent contractor) or from being self-employed. The dollar threshold of \$5,350 is adjusted annually.
- If a student has UNEARNED income over \$850 (in 2007), they owe federal income tax. Unearned income is income from investments such as interest on savings account, dividends from stock and mutual funds owned in a custodial account, and capital gains for the sale of stock or mutual funds. The dollar threshold of \$850 was not adjusted in 2007.
- If a student has SELF-EMPLOYMENT income over \$400, they owe Self-Employment tax (called SE Tax). Self-employment income is the profit from a business. SE Tax is the same as Social Security (FICA) and Medicare for self-employed people. The dollar threshold of \$400 has not been adjusted in decades.
- If a teenager (under age 18 at anytime during the year and a student) was a HOUSEHOLD EMPLOYEE, they do not owe Self-Employment tax. A household employee is a housekeeper, maid, baby-sitter, gardener, and others who work in or around a private residence as employees. This income is reported on Line 7 of the 1040 along with W-2 wages, but include a note “HSH” with the dollar amount of the household employee income earned.

These guidelines may be confusing. That is because there is more than one type of tax covered on the Form 1040. Both the income tax and self-employment tax are on the 1040. There is also more than one type of income that is taxed. There are forms and schedules for unearned income, self-employment income, investment income, etc. The thresholds vary depending on the type of income and type of tax. Some of the thresholds

are adjusted every year, but some have not been adjusted in decades (like \$400 threshold on self-employment tax). Here are examples from real life of teenagers earning money and their tax situation.

## **Real Life Examples**

### **Earned Income**

Lauren works at Sears and makes \$3,100. Lauren does not owe federal income tax because her wages are under \$5,350. She could file a return to get a refund of any federal income tax withheld. She may file a state return to claim a refund 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 possibly state income tax.

### **Household Employee**

Emily earns \$800 babysitting and \$200 giving piano lessons. Social Security and Medicare taxes do not apply to the \$800 because she is a household employee. Her \$200 from teaching piano lessons is self-employment income, but under the \$400 threshold to pay Self Employment tax. She should still file a Schedule C (Profit or Loss from Business)

Kurt earns \$2,000 mowing lawns for neighbors. Kurt will not owe Social Security and Medicare taxes because he is under 18 and a household employee. He will not owe federal income tax because \$2,000 is under the threshold of \$5,350 for federal income tax (for 2007).

### **Self-employed Income**

Kurt mows grass for a cemetery and gets paid \$1,000 on a 1099 MISC. He is considered an independent contractor and will owe Self Employment (SE) tax. He will not owe federal income tax because his income is under the \$5,350 earned income threshold (for 2007). Kurt should file a 1040 to pay his Self Employment tax.

Phil does web design and earns a profit of \$6,000. Phil owes Self Employment tax and federal income tax, and, likely, state income tax.

### **Unearned Income**

Tom has a large savings account. He earned \$600 in interest. Tom does not have to file a tax return, nor owe any income tax because his investment income is under the \$850 threshold for unearned income.

Tom's dad manages his college fund. He sold stock for a capital gain of \$5,000. Tom must file a 1040 and include Schedule D (Capital Gain or Loss) and Form 8615 "Kiddie Tax". He will pay federal income tax at his parent's rate.

Tom's dad waited until he was 19 years old to sell the stock. He stills files a 1040 and Schedule D, but now pays federal income tax at his rate of 5%. There is no "Kiddie Tax"!

### **Common Questions from Teenagers (and suggested answers)**

#### **I do a service job (i.e. lawn care or babysitting), do I have to pay taxes on what I make?**

If you go to someone's home and provide a service, like lawn care or babysitting, you are classified as a "household employee." As long as you are under age 18 at anytime during the year and a student, your employer doesn't have to pay social security taxes on you. You are also not considered self-employed. You will not owe federal income tax until you make over \$5,350 (in 2007). Be careful to add up your household employee jobs and "regular jobs" (where you get a W-2). The total amount earned must be considered when doing your tax return.

#### **I want to start my own small business selling crafts. What do I need to report?**

Congratulations on living the American dream of being your own boss! You are considered self-employed and will pay two types of taxes: income tax and self-employment tax (called SE Tax). SE Tax is the same as Social Security (FICA) and Medicare for self-employed people. You will report all your income and expenses on an IRS form called Schedule C Profit or Loss from Business when you file a 1040. Many teens that have small businesses find that they do not owe federal income tax, but do owe self employment tax. (at 15.3% of their profits!). Keep good records of everything you earn and everything you spend on your business. It's a really good idea to talk to an accountant when you start your business. They may also help you with issues like sales tax.

#### **What if I get paid in cash?**

According to the IRS, all types of earned income are subject to income tax. It doesn't matter if you get paid by check from an employer (such as working at a fast food restaurant) or in cash by your neighbor (for mowing his or her lawn). How you are paid doesn't matter to the IRS. The important point is that you report your income and pay tax on it if you need to.

#### **My new boss wants me to be an Independent Contractor, not an employee. What's the difference?**

Independent contractors are hired for a specific task or project (like plumbers), bring their own tools, may work for several clients, and do not need training. Examples of typical independent contractor jobs include sales, newspaper carriers, computer design, computer repair, entertainers, babysitting, and tutoring.

An independent contractor is a self-employed person and pays both halves of Social Security and Medicare taxes called SE (Self-Employment) Tax. On the other hand, employees have half of their Social Security and Medicare deducted while their employer pays the other half. Teenagers may owe significant Self-Employment taxes at the end of the year even if they do not owe Federal Income Tax!

The good news is that if you are an independent contractor, many expenses for travel, tools, equipment, etc are deductible as business expenses (you must fill out a Schedule C Profit or Loss from Business).

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