

The Early Bird Gets the Worm: Roth IRAs for Teens

By Jeanne Lee

Looking for a way to set your teenagers up for financial success down the road? Get them off to a goodâ??and earlyâ??start by opening Roth individual retirement accounts (IRAs) for them as soon as they start working. Put the power of time and compounding to work on their behalf. Youâ??ll be surprised at the result.

Mike Gray is a dad who thinks ahead. Far ahead. When his son and daughter were teenagers, he set up wonderful tax-free gifts for them to help secure their financial futures.

When his kids got their first jobs, he opened Roth IRAs for them. Gray, a financial advisor in CAPTRUSTâ??s Raleigh headquarters office, put in an amount matching their modest earnings. He continued contributing to those accounts for years.

Retirement accounts for teens? It may sound premature until you consider that the golden rule of retirement savings is to start early so the savings have more time to grow. Financial advisors often point out that 20-somethings who start saving a little each month gain a big time advantage over those who wait till their 30s or 40s to get started.

By the same reasoning, why not help your child reap the benefits of an extra-long investment time horizon of 50 years or more? A Roth IRA, funded with after-tax dollars and that grows tax-free, is well-suited to help with this goal.

Eligible with a First Job

Just like adults, kids of any age are permitted to contribute to Roth IRAs as long as they have wages or compensation within Internal Revenue Service limits. In 2018, the maximum contribution is $5,500 or the amount earned, whichever is less.

Minors need a parent, grandparent, or other adult to open custodial Roth IRAs in their names. And itâ??s fine for an adult to make the contributions on the childâ??s behalf.

Grayâ??s daughter got her first real job at a summer camp at about age 14. She earned less than $2,000 that year, he recalls. She was allowed to keep her paychecks and spend the money as she liked. Gray opened the Roth IRA in her name and made a contribution in the amount she earned. Every year she had a job, he matched the amount. â??Iâ??ve made contributions for eight or nine years now, in whatever amount her earnings were,â?• says Gray. â??She has a real job now, as a nurse, so I put in the full Roth amount each year.â?•

When his son turned 15 and got a job as a lifeguard, Gray opened a Roth IRA for him, too.

His kids are in their 20s now, and he hasnâ??t told them yet.

Lots of Time for Investments to Grow

Hereâ??s why an early start is a gift in itself. Say you gave your 25-year-old child $5,500 to invest. After thirty years, the money would grow to $41,867, assuming 7 percent growth, compounded monthly.

But you could double the impact of your gift by giving it to your child at age 15. After forty years, assuming the same rate of return, the $5,500 would grow to $82,360.

Consider what would happen if your 25-year-old child funded a Roth IRA for 10 years, then stopped making contributions. After 30 years, the account would be worth $314,643 (assuming equal monthly contributions adding up to $5,500 a year and a 7 percent annual return, compounded monthly).

What if you helped your child make the same investment a decade earlier, at age 15? The difference would be huge. After 40 years, at the same rate of return, the sum would grow to $618,951.

â??Getting started that early is really powerful as far as the value of compound growth. Itâ??s pretty amazing the effect of another 10 years,â?• says Gray.

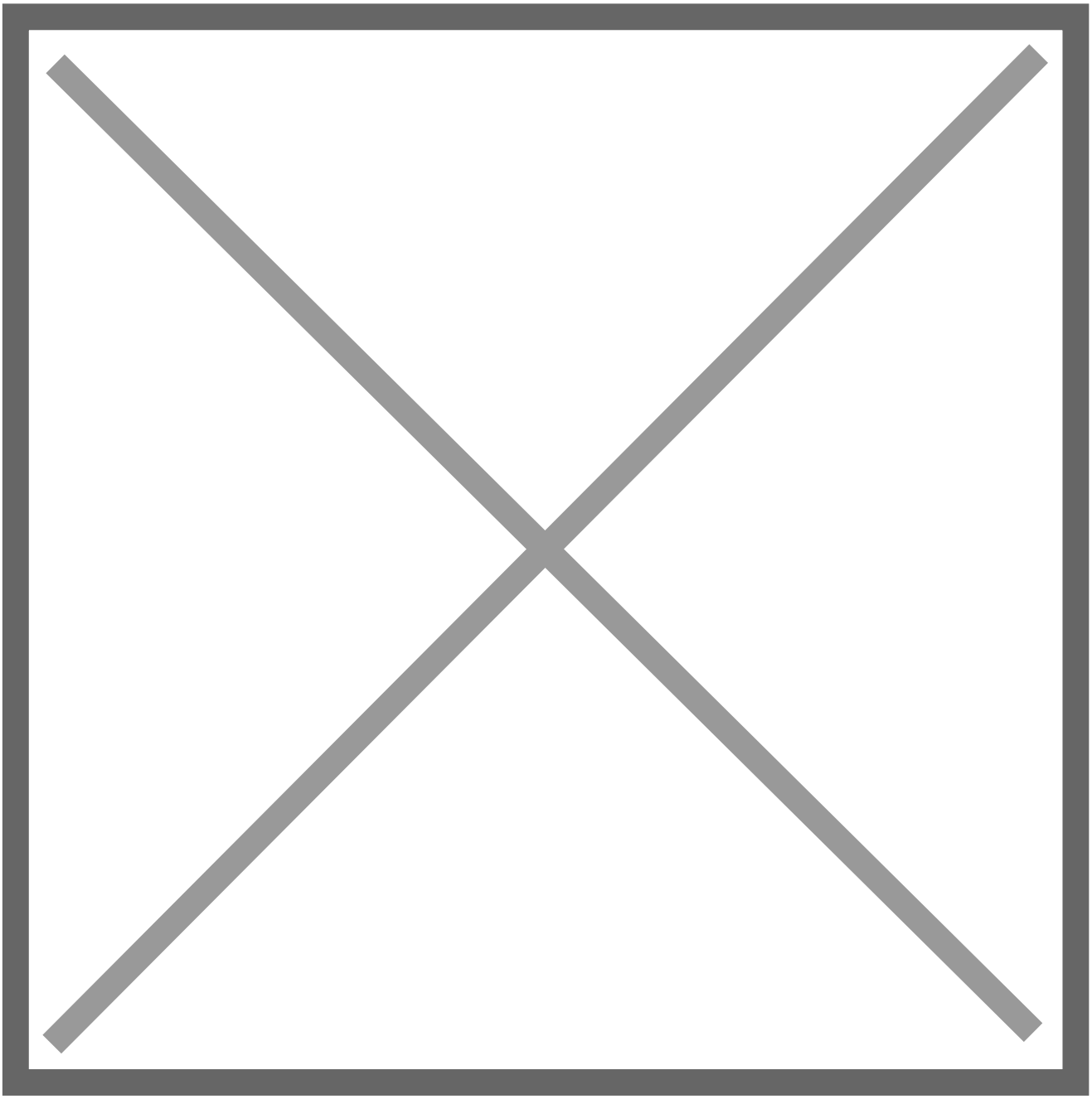
Kid-Friendly Tax Rates

Roth IRA rules are great for young people. Kids generally pay little or no taxes, so it makes sense to use after-tax dollars in a Roth rather than tax-deferred dollars in a traditional IRA. Decades down the line, all withdrawals from the Roth IRA after age 59Â½ will be completely tax-free, barring a change to Roth IRA tax treatment.

Non-Retirement Uses of Roth IRA Funds

Roth IRAs work best if the money is left to grow undisturbed until retirement. However, the rules are flexible enough to allow funds to be tapped under some circumstances.

Contributions have already been taxed, so they can be withdrawn at any time.



Earnings, or investment returns, are treated differently. Prior to age 59Â½, early distributions of earnings are generally subject to income tax, a 10 percent penalty, or bothâ??with some important

exceptions:

- **Funds for a first home**â??A Roth IRA could help your child buy a first home, a goal that escapes many young adults. Homeownership is near 20-year lows among millennials, according to the Brookings Institute, a nonprofit public policy organization. Your child could use Roth IRA funds, within limits, toward a down payment when it comes time to buy a first home. He or she could withdraw up to $10,000 of the earnings, without tax or penalty, provided the account has been open for at least five years. Before the five-year mark, income tax would apply, but not the penalty.
- **Funds for college**â??Roth IRA contributions can be pulled out for any reason, including college expenses. When your child goes to college, he or she could also withdraw earnings without penalty if they are used toward college tuition, room and board, or other qualified higher education expenses. Earnings would be subject to income tax.
- **Funds for emergencies**â??In bad times, Roth IRAs can become emergency funds. In addition to contributions being accessible, IRS rules allow earnings to be withdrawn without penalty for specific emergencies. These include becoming disabled, having to pay for health insurance premiums while unemployed, and having high medical expenses.

Gray plans to reveal his childrenâ??s Roth IRAs to them one day, though he hasnâ??t decided when. It might be when the balances reach a nice, round number, like $50,000, or some kind of special occasion. â??Marriage might be something that triggers it. Itâ??s a gift, but it comes with caveats,â?• he says. The big news will come with a serious discussion about using the money wisely.

For now, those gifts that date back to their summer camp and lifeguarding years continue to grow, tax-free.

Have questions? Need help? Call the CAPTRUST Advice Desk at 800.967.9948 or schedule an appointment with a retirement counselor today.

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