# Roth IRAs for Kids

If you have a child who works, consider encouraging the child to use some of the earnings for Roth IRA contributions. All that is required to make a Roth IRA contribution is having some earned income for the year. Age is irrelevant. Specifically, for 2012 your child can contribute the lesser of: (1) earned income or (2) $5,000.

By making Roth IRA contributions for just a few years now, your child can potentially accumulate quite a bit of money by retirement age. Realistically, however, most kids will not be willing to contribute the $5,000 annual maximum even when they have enough earnings to do so. Be satisfied if you can convince your child to contribute at least a meaningful amount each year. Remember, if you are so inclined, you can make the Roth IRA contribution for your child.

Here's what can happen. If your 15-year-old contributes $1,000 to a Roth IRA each year for four years starting now, in 45 years when your child is 60 years old, the Roth IRA would be worth about $33,000 if it earns a 5% annual return or $114,000 if it earns an 8% return. If your child contributes $1,500 for each of the four years, after 45 years the Roth IRA would be worth about $50,000 if it earns 5% or about $171,000 if it earns 8%. If the child contributes $2,500 for each of the four years, after 45 years the Roth IRA would be worth about $84,000 if it earns 5% or a whopping $285,000 if it earns 8%. You get the idea. With relatively modest annual contributions for just a few years, Roth IRAs can be worth eye-popping amounts by the time your child approaches retirement age.

For a child, contributing to a Roth IRA is usually a much better idea than contributing to a traditional IRA for several reasons. The child can withdraw all or part of the annual Roth contributions—without any federal income tax or penalty—to pay for college or for any other reason. (However, Roth earnings generally cannot be withdrawn tax-free before age 59½.) In contrast, if your child makes deductible contributions to a traditional IRA, any subsequent withdrawals must be reported as income on his or her tax returns.

Even though a child can withdraw Roth IRA contributions without any adverse federal income tax consequences, the best strategy is to leave as much of the account balance as possible untouched until retirement age in order to accumulate a larger federal-income-tax-free sum.

What about tax deductions for traditional IRA contributions? Isn't that an advantage compared to Roth IRAs? Good questions. There are no write-offs for Roth IRA contributions, but your child probably will not get any meaningful write-offs from contributing to a traditional IRA either. That is because an unmarried dependent child's standard deduction will automatically shelter up to $5,950 of earned income (for 2012) from federal income tax. Any additional income will probably be taxed at very low rates. Unless your child has enough taxable income to owe a significant amount of tax (not very likely), the advantage of being able to deduct traditional IRA contributions is mostly or entirely worthless. Since that is the only advantage a traditional IRA has over a Roth IRA, the Roth option almost always comes out on top for kids.

By encouraging kids with earned income to make Roth IRA contributions, you're introducing the ideas of saving money and investing for the future. Plus, there are tax advantages. It's never too soon for children to learn about taxes and how to legally minimize or avoid them. Finally, if you can hire your child as an employee of your business, some additional tax advantages may be available.