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Using IRAs to Help Children in 5 Easy Steps

Can children have IRAs? There is no minimum age for having an IRA. Due to the power of compound interest, saving tax-free in an IRA from childhood can provide a significant head start on financial security. Saving $7,000 in an IRA annually from age 14 through 24 and earning 7% per year provides over $1 million at age 61—even without contributing after age 24!

1. **Open an IRA for every child who has earned income.** The yearly contribution limit currently is $7,000 or the amount of the child's earned income, whichever is less. Any kind of paying work will do: babysitting, waiting tables, and so on. Wages can come from a family business. Note: for a minor child (under age 18 to 21, depending on state law), you will need to set up a "guardian IRA" account. These are now offered by many banks and financial institutions.
2. **Give children money to make IRA contributions.** If children want to spend their income from working, that's okay. You can gift money to children to fund IRA contributions.
3. **Use a Roth IRA.** Contributions to Roth IRAs can be withdrawn at any time for any reason with no income tax or early withdrawal penalty resulting, creating savings available at any time. Plus, investment gains in a Roth IRA can eventually be withdrawn tax free. In contrast, distributions from traditional IRAs are taxable and subject to a 10% penalty before age 59 ½. The deduction for contributions to traditional IRAs is worth little or nothing when a child is in a very low or 0% tax bracket.
4. **Invest the Roth IRA for the long term.** Although stocks have averaged a 7% real return in the past, they can be volatile, creating risk for persons in or near retirement years. Children need not fear this risk because they have a long time line. Too safe investments can actually be costly for them. A steady, sure 3% return from bond-like investments reduces the $1 million in our earlier example to only $229,000.
5. **Keep good records for children.** Make sure a child's income is "on the books" and reported on a parent's or the child's own tax return. If the child's income comes from a family business, document that it is genuinely earned, and monitor the IRA's investments carefully.

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