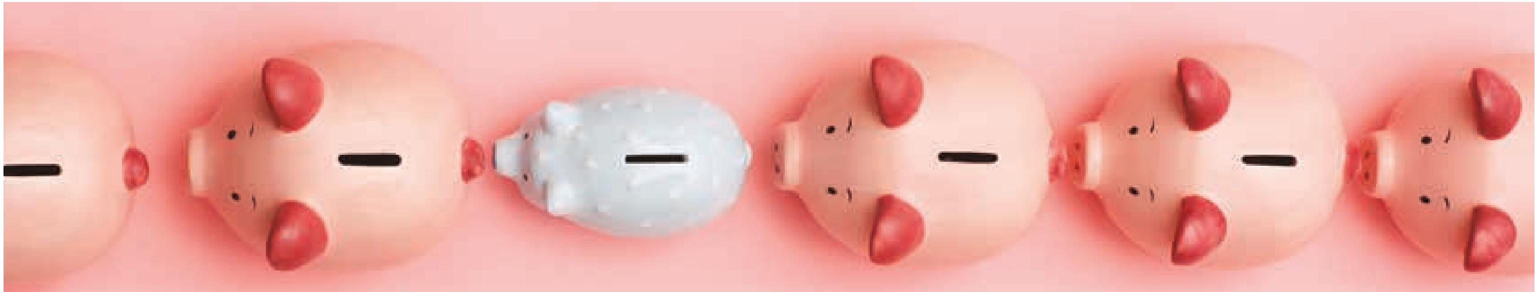

Turn Your Kid *Into A* ROTH CHILD

financial fitness

By **Rocky Mills,** North Ranch Resident

Bad Pun. Good Idea.

The idea is simple. Set your child (or grandchild) up with tax-free savings for life by taking advantage of the Roth IRA.

First, the child has to have a job that pays reportable income. The entirety of that income amount, up to $5,500, can then be deposited into a Roth IRA (unless the child has a really good job earning more than $117,000, at which point the amount that can be contributed to a Roth starts to phase out; if this child is married, the phase out starts at $184,000).

If you're so inclined, you can help fund the contribution – there's nothing that says the Roth IRA contribution has to come directly from the child's earnings. You could tell the child that you're going to reward their hard work by setting aside funds for their retirement – you'll deposit as much as they earn each year, up to the $5,500 ceiling. Or, perhaps you would like them to have a little "skin in the game", in which case you could use a matching scheme, such as: for every $1 saved, you add $2 (up to the $5,500 ceiling, of course).

The point is, if they start a "retirement account" at an early age, it will foster a lifetime of good saving habits and bolster their chances of a successful retirement.

But why a Roth – why not a regular IRA? With a regular IRA, the annual contribution becomes a deduction against income for taxes. That's not the case for Roth IRA contributions – there's no deduction. But generally the child is going to be in a very low, perhaps 0%, tax bracket. So a deduction wouldn't be worth much anyway.

Here's the best part. Unlike a regular IRA where withdrawals are fully taxed, the child can take money out of a Roth IRA tax free!! He or she can always take out their contributions without tax or penalty. And to take out the earnings without tax or penalty, (1) the Roth IRA has to have been funded for at least 5 years, and (2) the owner has to be age 59.5.

Age 59.5 sounds like a long way away for a child. But there are a couple of ways (among many) to also take out the earnings, as long as the Roth has been funded for 5 years:

1. **First Home –** They can withdraw up to $10,000 of earnings to buy their first home without tax or penalty. So let's say that when the child is ready to buy their first home, their Roth IRA is worth $80,000 – $55,000 from contributions and $25,000 from earnings. They could withdraw $65,000 to invest in their new home without any tax or penalty – all of the $55,000 that was contributed and $10,000 of the earnings.

2. **College –** They can withdraw earnings for higher education expenses without penalty, but it will be taxed. So, let's assume that when the child is ready for college, their Roth IRA is worth $28,000 – $22,000 from contributions and $6,000 from earnings. First, the entire $22,000 of contributions can be taken out without tax or penalty. The $6,000 of earnings can come out without penalty, but there will be some tax. However, it's likely to be very little owing to their limited income.

For further information, review IRS Publication 590. And, as always, chat with your tax advisor on such matters.

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