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Starting a Roth IRA for a Teen

This holiday season, consider gifting the teenager in your life a custodial IRA

Want to give your child or grandchild a financial head start? A Roth IRA might be a choice to consider. Read on to learn more about how doing this may benefit both of you.

Rules for Setting up a Roth IRA

If your teen has an earned income, you may be able to set up a Roth IRA for them. For example, if your 15-year-old has earned \$7,000 at a summer job, you can set up an account for them up to \$7,000 (the maximum annual Roth IRA contribution for 2024). The amount cannot exceed the teen’s income. Keep in mind that money that you contribute to the Roth IRA can count as a gift within your \$18,000 yearly gift tax exclusion (\$36,000 for a married couple).¹

Looking Ahead to the Future

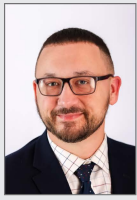
If money is withdrawn from a Roth IRA before age 59½, a 10% federal tax penalty may apply. There is, however, a notable exception. Up to \$10,000 of investment earnings can be taken out of a Roth IRA at any time if the money is used to buy a first home. In this instance, the IRS may waive the early withdrawal penalty. Down the road, a portion of those Roth IRA assets might also be utilized to pay college tuition costs for oneself or one’s child.^{2,3}

This article is for informational purposes only. It’s not a replacement for real-life advice, so make sure to consult your trusted financial and tax professionals before modifying any Roth IRA strategy. Tax-free and penalty-free withdrawals also can be taken under circumstances other than first-home purchases, such as the owner’s death. The original Roth IRA owner is not required to take minimum annual withdrawals. To qualify for the tax-free and penalty-free withdrawal of earnings, the teenager must meet a five-year holding requirement and the withdrawal must occur after age 59½.

Greater Earning Potential, Thanks to the Magic of Compound Interest

Setting up a Roth IRA for a teenager is a great way to introduce them to basic financial concepts, such as compound interest. Giving your teen a hands-on learning experience may help them understand the value of saving for the future. You may also be facilitating the development of their financial habits.

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There are a Few Things to Consider When Setting up a Custodial Roth IRA

Setting up a Roth IRA for a minor is often referred to as a custodial IRA. Until the child is able to take it over, you act as the custodian of the account. Individual state laws determine when the minor child is able to take over management of the Roth IRA for themselves.

Your financial and tax professionals can provide guidance that may help ensure that you and your minor child or grandchild are following all federal and state regulations.

Citations.

1. Investopedia.com, January 28, 2024
2. IRS.gov, 2024
3. IRS.gov, 2024

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