Retirement Accounts for Kids

Most everyone who saves for financial independence usually says, “I wish I had started earlier.” Wouldn’t it be great to give your minor children or grandchildren a leg up on securing their own financial freedoms decades before most people even begin to think about saving for their retirements?

If you have successfully funded or are on track to securing your own financial independence, your disciplined savings habit is a testament and inspiration for future generations in your family. Passing on the benefits of what Albert Einstein called the eighth wonder of the world—compound interest over long periods of time—will not only enrich your children and grandchildren figuratively, it will literally become a life changer for their financial futures and a lasting legacy from the one who inspired them to faithfully save a portion of what they earn—you.

The ideal place for ultra-long-term retirement savings to grow is a tax-free Roth IRA. A parent or grandparent can open a minor’s Roth IRA account regardless of the child or grandchild’s age with the minor’s Social Security number and appoint himself or herself as custodian for the account until the minor child reaches the age of majority (age eighteen in most countries and most US states). Be advised, not all financial institutions support the opening of a minor’s Roth IRA. Do your homework to locate a willing institution.

Contributions to a minor’s Roth IRA can be 100 percent of the child’s earned income up to a maximum of $5,500 per year. In reality, it’s difficult for young wage earners to part with a portion of their paycheck and not see it again for many years. It’s especially hard when there are so many enticements competing for each dollar earned. Funny how this same spending and savings dilemma continues for older savers too. But what if you told your minor child or grandchild this: If you save part of your earnings for a future time in your life before you spend it—say 10 percent—and invest it in your Roth IRA, I will match the remainder of your income up to 100 percent of what you earn this year. Now that’s an incentive!

Current law doesn’t require that a contribution to a Roth IRA be paid directly from a minor’s earned income. In other words, the child or grandchild could hypothetically earn $2,000 a year in wages, contribute 10 percent, or $200, to his or her Roth IRA and the parent or grandparent could gift the difference ($1,800) to the Roth IRA. If other monies are being gifted to the child or grandchild outside of the minor’s Roth IRA gifted amount, the annual estate tax exception for all gifts in a calendar year by a single grantor to a single recipient is $15,000 (2018 amount).

As custodian of the minor's Roth IRA, you would control the account until the minor reached the age of majority (age eighteen to twenty-one, depending on your state of residence). After reaching that age of majority, he or she would be free to use the money in the Roth account for any reason without your permission. This potential drawback can become a valuable opportunity to provide important education to young savers—specifically, to help them understand the high cost of liquidating long-term retirement savings for short-term impulses and to understand the benefits of long-term investing discipline. In the end, it's the young adult's decision.

Be careful not to put future restrictions or conditions on any gifted money, as that would negate the spirit of the gift.

If lifetime control of your invested portion into your children's or grandchildren's retirement account is a concern, other options such as a trust can be explored. Be careful to consider how investments for a minor's benefit might affect future financial aid applications. Roth IRA account balances aren't reported as assets on the form known as the Free Application for Federal Student Aid (FAFSA), regardless of whether they're owned by the student or the parent.

Imagine what it would have meant to you today if a parent, grandparent, or other family relative had approached you when you first started to earn an income and had encouraged you to begin to save part of what you earned toward your later-life financial independence—and had invested with you toward that end. Priceless.

I can think of no greater legacy than the gift of time and money that have been well employed.

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