

# Create Tax Savings And Transfer Wealth To Your Child With A Roth IRA

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Parents must give serious thought to protecting their family through estate tax planning. While life insurance and trusts should be a part of every plan, Roth IRAs can be a simple tool for passing money to your child on a tax-free basis.

## Roth IRA

First, we need a quick summary of the Roth IRA. A Roth IRA is an after-tax retirement vehicle that produces huge tax savings because all tax distributions are tax-free. That statement can be a bit confusing, so let's break it down. The downside of a Roth IRA is the fact that contributions are not tax deductible as with traditional IRAs or 401(k)s. The upside of a Roth IRA, however, is that all distributions are tax-free once the person reaches the age of 59½. So how can you use a Roth IRA to pass money to your child?

## Opening A Roth IRA For Your Child

One of the biggest keys to retirement planning is "time". The more years you spend saving money for retirement, the more you should have when that blessed day arrives. Imagine if you had started saving for retirement when you were 16. How much bigger would your retirement nest egg be? What if you purchased Microsoft stock in 1990 and watched it split eight times? Okay, that was a painful example if you missed that opportunity. Nonetheless, why not do for your child what you didn't do for yourself?

The fundamental goal of estate planning is to pass as much of your estate as possible to your family on a tax-free basis. You can transfer relatively small amounts of money to your child now. If you have a 16 year-old child with a Roth IRA, you can contribute \$4,000 in 2005. That \$4,000 is going to grow tax-free for 43 years and be worth quite a bit. A ten percent return would result in the account growing to roughly \$200,000 and the full amount would be distributed tax-free. There are other practical advantages to opening a Roth IRA for your child.

As a parent, it is vital that you teach your child the value of money. Opening a Roth IRA gives you the opportunity to sit down and teach your child the value of saving and investing, instead of yelling at them to clean their room. While a parental lecture on the need to save money would typically meet with glassy eyes and yawns, your child's attitude will undoubtedly change when you are talking about their money.

## Work and Maturity Issues

Before you rush out to open a Roth IRA for your child, you must determine if your child is eligible to open an account. To open an account, your son or daughter must be working at least part time for an employer that reports their wages to the IRS. Hiring your child to take out the trash each week is not going to cut it, nor will this strategy work for your 5 year-old. Many teenagers, however, have summer jobs that should suffice for IRS consideration. To avoid any trouble, you should consult with your tax advisor.

A more sublime issue concerns the maturity level of your child. Keep in mind that the Roth IRA will be opened in their name. Your son or daughter will have the legal right to do what they will with the account. It is strongly suggested that you clearly explain the consequences of taking money out of the account [taxes, penalties, being cut out of the will, forced to eat healthy food, grounded for life, etc.] but the decision lies with them. As difficult as it is, try to be objective in evaluating how your child will react to knowing the money is sitting in an account. If you have doubts, you should probably investigate other tax saving strategies.

Opening a Roth IRA for your child can be a very effective means of transferring wealth to your child and teaching important life lessons. If your child exercises restraint, your relatively small contribution to their Roth IRA can grow into a sizeable tax-free nest egg.

#### About The Author

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