Help Get Your Teen Started with A Roth IRA

To be successful in most endeavors, it's important to develop good habits — and that's certainly the case for investors. And the earlier one develops these habits, the better. So, if you have teenagers who may be starting to work at part-time jobs, now may be a great time to introduce them to investing — and one place to begin might be a Roth IRA.

As you may know, a Roth IRA is a popular retirement savings vehicle — its earnings can grow federally tax-free, provided withdrawals aren't taken until the investor is at least 59½ and has had the account five or more years. But because a Roth IRA is funded with after-tax dollars, contributions can be withdrawn at any time, penalty-free, to pay for any expenses — including college. Roth IRA earnings can also be used to help pay for college, although these withdrawals will be taxable. However, if a child is the account owner, a lower tax bracket will likely apply.

In 2023, up to $6,500 per year can go into your teenager's Roth IRA, as long as the amount contributed doesn't exceed the amount of their taxable compensation for the year. And your child doesn't have to put all the money in — you and the child's grandparents can also contribute. In fact, you might want to "match" your child's contributions up to the limit to provide an incentive for them to continue investing in the Roth IRA. Not only will your matching contribution help build the Roth IRA's assets but it can also instill in your child's mind the benefit of earning a match – which can prove valuable later on, when your child is in the workforce full time and has a chance to receive an employer's matching contributions in a 401(k) or similar plan.

Your child may well find a job at a local restaurant or shop, as these businesses have experienced a shortage of workers the past couple of years. But if you have a family business, you can employ your teen to provide income that can go into a Roth IRA. Furthermore, if the business is one parent's sole proprietorship, or it's a partnership in which each partner is the parent, the payments for a child younger than 18 are not subject to Social Security and Medicare taxes. As an employee, your child must perform reasonable tasks necessary for the business and be paid reasonable wages — that is, wages comparable to what you'd pay a regular employee for the same work.

But wherever your child's wages come from, using some of them to help fund a Roth IRA can be a good move. For one thing, it gives you a chance to explain the value of putting time on your side when you invest — simply put, the more years you invest, the greater your chances of accumulating the resources you need to meet your goals. And by helping your teen open a Roth IRA, which holds stocks, mutual funds or virtually any other type of security, you can discuss the different risk/reward characteristics of various types of investments — the kind of basic knowledge that all investors should have.

Once your teen's first paychecks start coming in, consider bringing up the idea of opening a Roth IRA — you may well be opening the door to a lifetime of consistent and informed investing.

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