Retirement Savings: the Earlier, the Better

Article Summary:

- Teenagers and young adults
- Tax-free accumulation
- Earned income requirement
- Roth IRA

Generally, teenagers and young adults do not consider the long-term benefits of retirement savings. Their priorities for their earnings are more for today than that distant and rarely considered retirement. Yet contributions to a retirement plan early in life can enjoy years of growth and provide a substantial nest egg at retirement.

Due to its long-term benefits of tax-free accumulation, a nondeductible Roth IRA may be the best option. During most individuals' early working years, their income is usually at its lowest, allowing them to qualify for a Roth IRA at a time where the need for a tax deduction offered by other retirement plans is not important.

Because retirement will not be their focus at that age, young adults may balk at having to give up their earnings. Parents, grandparents, or other individuals might consider funding all or part of the child's Roth contribution. It could even be in the form of a birthday or holiday gift. Take, for example, a 17-year-old who has a summer job and earns $1,500. Although the child is not likely to make the contribution from his or her earnings, a parent could contribute any amount up to $1,500 to a Roth IRA for the child.*

But keep in mind that young adults, like anyone else, must have earned income to establish a Roth IRA. Generally, earned income is income received from working, not through an investment vehicle. It can include income from full-time employment, income from a part-time job while attending school, summer employment, or even babysitting or yard work. The amount that can be contributed annually to an IRA is limited to the lesser of earned income or the current maximum of $5,500.

Parents or other individuals who contribute the funds need to keep in mind that once the funds are in the child's IRA account, the funds belong to the child. The child will be free to withdraw part or all of the funds at any time. If the child withdraws funds from the Roth IRA, the child will be liable for any early withdrawal tax liability.

Consider what the value of a Roth IRA at age 65 would be for a 17-year-old who has funds contributed to his or her IRA every year through age 26 (a period of 10 years). The table below shows what the value will be at age 65 at various investment rates of return.

Value of a Roth IRA—Annual Contributions of $1,000 for 10 years beginning at age 17				
Investment Rate of Return	2%	4%	6%	8%
Value at Age 65	$23,703	$55,449	$127,900	$291,401

What may seem insignificant now can mean a lot at retirement. Individuals who are financially able to do so should consider making a gift that will last a lifetime. It could mean a comfortable retirement for your child, grandchild, favorite niece or nephew, or even an unrelated person who deserves the kind gesture.

**Amounts contributed to an IRA on behalf of another person are nondeductible gifts by the donor and are counted toward the donor's annual $14,000 (2014 and 2015 gift exclusion per done).*

If you would like more information about Roth IRAs or gifting contributions to a Roth on behalf of someone else, please contact this office.