

# Roth IRAs for Children Gain Favor With Moms and Dads

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With his surfboard and skateboard, Bret Hartt is the quintessential Southern California teenager, but for one thing -- his Roth IRA.

At the age of 15, Bret has socked away \$8,416 in an individual retirement account. Left untouched, and compounding at a relatively conservative 7% annually, it could be worth a quarter of a million dollars, tax-free, when he is ready to retire.

Such early planning for old age is becoming more and more common. Children who have earned income are eligible for a Roth, just like adults. And the number of minors who hold Roth IRAs has nearly doubled in the past year to about 903,000, according to the Investment Company Institute, an industry group in Washington, D.C.

That comes as the number of households with any Roth grew just 8% and the overall number of households with IRAs remained relatively flat, at 42 million.

Roths are still relatively new, around only since 1998, but more investors are coming to understand their tax benefits over traditional IRAs, financial advisers say. For youngsters, these benefits are especially favorable. And advisers say that parents searching for financial tools for both themselves and their children are increasingly making the connection.

## **Lots More Interest Seen**

"We've seen a lot of interest in the last year and a half," says Peter Syslack, retirement-services manager for Strong Financial Corp., in Menomonee Falls, Wis. Strong's Web site now includes information about Roths in a section devoted to IRAs for minors, he says, and the company likely will do more marketing in the future.

"A lot of individuals come and say their children are earning some additional money," and they ask, "What can they do with it?" Mr. Syslack says.

Take Bret. The San Pedro, Calif., teen worked part-time as a handyman at his family's mobile-home park. His parents learned about Roth IRAs from their adviser shortly after the accounts became available in 1998. They hadn't considered retirement planning for Bret and his brother, Brooks, now 20. But when they learned their sons were eligible for Roths, they opened accounts for both boys.

Unlike with a traditional IRA, where investors can get a tax benefit on contributions but the withdrawals are taxable, Roth contributions are made with after-tax dollars, and withdrawals are tax-free. That makes them especially appealing for children.

Contributions are taxed at the holder's rate, usually little or nothing in the case of a youngster, and the principal has the potential to compound for perhaps half a century before the holder needs it.

## **There Is Flexibility Also**

There also is some flexibility: Contributions can be withdrawn for college expenses, and up to \$10,000 can be taken out for a first-time home purchase, both without taxes or penalties. And while you have to be at least 59½ to take out money for retirement, Roths have no mandatory distributions, unlike traditional IRAs, which require the holder start taking out money at age 70½ or be penalized.

If your children aren't interested in saving for something 40 or 50 years away, you can do it for them. The contribution can be made by parents, grandparents or others, as long as it doesn't exceed the child's actual earned income or the maximum allowable contribution, now capped at \$3,000 a year and growing incrementally to \$5,000 in 2008, according to the Internal Revenue Service.

Roths don't work for everyone under 18. The biggest barrier: Contributions are based on earned income, so youngsters who don't work aren't eligible. If that isn't an issue, control might be.

Accounts are opened under a custodial arrangement, with an adult in control. But once minors turn 18, the money is all theirs. They will then be responsible for managing the investments in the account. And if they want to withdraw it early and go on a spending spree, they can. Mom and Dad may be stuck paying the 10% penalty and the taxes.

Still, Kevin McKinley, a financial planner in Eau Claire, Wis., routinely recommends Roths to his clients. "I rank it right behind college savings plans, but a very close second," says Mr. McKinley. "You can relatively easily borrow money to go to college, but our kids can't borrow money to retire."

## **Modeling Money**

He opened a custodial Roth for his own daughter Ellie, age 3½, funded with the \$2,000 she made modeling for the cover of her father's book, "Make Your Kid a Millionaire." If that money grows at 10% annually, he says, she'll have over a million dollars to withdraw by the time she is 67, without ever paying taxes on it.

Of course, your child doesn't have to be a cover girl or boy to open a Roth. The key is that the income has to be "legitimate."

In other words, don't consider paying your child \$3,000 a year to take care of the family dog. But more unusual tasks, such as painting the house, could count. More typical would be work in a family business or in the outside world -- flipping hamburgers or mowing lawns.

No matter the source of the income, it is important to keep records of exactly when and how it was earned in case the IRS ever questions the income, says Phillip Cook, a financial planner in Torrance, Calif., who recommended Roths to the Hartt family.

W-2 forms are best, but the IRS also would accept a log that covers what work was done, when and the compensation. Children generally don't need to file a tax return unless their earned income was greater than the standard deduction (\$4,550 for 2001).

## **Minimum Deposit**

There is no minimum earning requirement to open a Roth, though financial institutions typically have a minimum deposit. At some firms, such as Strong Financial, the minimum is as low as \$250. The maximum allowable adjusted gross income to be eligible for a Roth is \$110,000 for individuals -- but few youngsters would be lucky enough to hit that.

Many family-finance experts say this is a perfect opportunity to teach children about long-term saving and how the markets work. Carrie Cooper, an investor-center manager for mutual-fund company American Century Investments in Kansas City, Mo., says she sees clients do just that.

One grandfather regularly brings in his grandchildren and has them hand over their deposits to their financial planner, then go over their statements.

For his part, Bret Hartt says he reviews his quarterly Roth statements, and they have made an impression. "I definitely would do this for my own kids," he says.