Your Kids, Saving, And Roth IRAs

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As parents, we want our kids to become self-sufficient, thriving adults, and part of that "want" is for them to be financially independent, responsible, and on the path to creating financial security. In a society where spending is so visible, so celebrated, and so dang easy, it is tough to model a savings mentality. Saving strategies are largely invisible to our kids – our 401k contribution comes out of our paycheck, and most aren't sitting around sharing that pay stub with the family. Transfers to savings and investment accounts are electronic and done behind the computer screen. Again, most of us aren't talking to our kids about how much we save or how much we have accumulated via those savings plans.

Unless we take *intentional* action with our kids to promote saving and to share the how and the why with them, they will pick up on what they see – a lot of spending. Here are some ideas for parents to start at whatever age their kids happen to be.

For younger kids, the tried-and-true piggy bank is a helpful way to get them used to taking some part of their "income" and stashing it away for the future. You can have them save up for "the future" which is what adults must do and have them save for some bigger item that they want. Both help with delaying gratification, something that is not encouraged by the marketing industry, and help them see the need to have funds set aside because it is important to be able to get money if it is needed. We may not know why we'll need it or exactly when we'll need it but having it creates some security.

As kids get to the teen years and have a paycheck, it is time to communicate the important lessons about using funds for some "needs" and not just for "wants." This is the downside of adulting, but the day is fast approaching when they must pay their way so getting used to saving and perhaps assuming responsibility for things like gas for the car, buying some of their clothes, etc. can help them understand that every dollar earned should not be a dollar spent.

An obvious first step is to open accounts like savings and checking accounts. You can walk into your bank with your teen and open accounts like we did when we were kids (Does anybody remember having a "passbook?" Yes, I am that old.). Some banks allow teens to have their own account in their name before age 18; others may require a parent to be a joint account holder. Regardless, I recommend setting up balance alerts or some other method of monitoring because there are likely to be a few "oops" moments as your teen is learning the mechanics of banking, and overdraft fees are not cheap (Although offer a good teaching moment!).

There are now many online options for teens to open an account from the convenience of a phone. Do your research and check ratings and user comments. Sites like *NerdWallet* and *The Balance* have ratings for such accounts and a quick online search will lead you to articles and resources to help analyze the options. The important part is to make sure that you help your child understand how these accounts work and what tools the online app has for monitoring and tracking.

There are also companies offering debit cards for kids which have a lot of parental oversight, reporting, and monitoring capabilities. In a time when cash is giving way to electronic commerce, learning how to manage money when it is invisible is more important than ever. These can be used by much younger kids and can be set up to help them divide up their allowance with rules for saving, giving, and spending based on what you and your child agree upon.

I remember my kids struggled with the difference between an ATM card and a gift card. They had plenty of experience with the mechanics of gift cards with a set balance "on the card" which was used and then tossed. They had a harder time understanding that the ATM was not a "card with a balance" but rather a "key" to access an account at a bank. A lost card doesn't mean the loss of the funds "on the card" but rather a temporary inconvenience to the access of the account. These abstract concepts take some detailed explanations.

The more interesting part comes in working through the mechanics of depositing paychecks and setting up automatic transfers to savings and investment accounts. What a gift it is to teens to get them primed to have a formula for receiving money:

- X% to charity (if that's important to your family),
- Y% to the emergency savings account, and
- Z% to long-term investing.
- Maybe you add a C% for saving for college or a G% for paying for gas each week.

Teaching teens how to allocate their earnings to important goals and priorities sets them up for financial success throughout their lives. They don't need a job to be introduced to this structure. It is great to set priorities for any money they receive.

This is also an opportunity to teach them about the differences between interest on a savings account and opportunities for dividends and investment growth in an investment account. Savings accounts have low-interest rates because the safety of the principal is guaranteed – lower risk, lower reward (interest). Investing carries a risk of loss so must provide a greater reward (higher interest rate, dividends, or the opportunity for increases in the value of the investment).

When your teen does have earned income[1] (wages from a job), we recommend they open a **Roth IRA account**. The beauty of a Roth IRA is that the owner can invest those funds, and as long as they follow the Roth rules, they will never be taxed on the returns from those investments (called "unearned" income in tax lingo). Wow – that is a great deal! Interest, dividends, and capital gains over their lifetime build up and are never taxed (under the current tax rules anyway). Unearned "ordinary" income in a non-retirement investment account is subject to tax at "ordinary income" rates which go from 10% to 37%. Gains on investment sales and "qualified dividends" are subject to capital gains rates which are currently 0%, 15%, and 20%.

It is important to note that the contribution amount is limited to the lessor of earned income or the limit set in the Tax Code which is $6,500 for 2023 and $7,000 for 2024. Other important points:

- The contribution can be made *from any source* so a parent could incentivize savings by matching the teen's contribution. So, if the teen is going to contribute 20% of their income to the Roth, a parent could match that and gift the teen the money to contribute an additional 20%, thus, doubling the contribution to 40% of income. The limit would be that total

[1]Earned income is a tax-related term and indicates that wages and other such income is available for contributions to retirement accounts like IRAs and Roth IRAs while unearned income, like interest and dividends, is not available for such contributions.

contributions and cannot exceed the $6,500 (2023) and $7,000 (2024) limits.

- Everyone has until April 15th to make the contribution for the PRIOR tax year so you can fund 2023's contribution until April 15, 2024. (They must have earned income for 2023, though, so if they just got a job this year, they would be funding their 2024 contribution.)
- Your teen should report the contribution on his or her tax return for the year of contribution but is not required to. If no return was required to be filed or they have already filed for 2023, they can still contribute. They should track their contributions, and the custodian of the account will send a Form 5498 each year, usually in May, which they should keep for record-keeping purposes.
- There are income limits for making a direct contribution to a Roth so consult with your advisor if you (or your brilliant teen) have a substantial income.

How should they invest those funds? That is a topic for a different day (April 17th!), but this is a great way to get teens interested in and explore the differences between stocks, bonds, ETFs, and mutual funds. All online investing platforms like Schwab and Fidelity have tools and resources to help people learn about investing and are reputable sources of information. Many commission-free ETFs provide broad exposure to U.S. and international markets.

Time is your best friend in terms of investing so starting early and investing consistently will make their march toward financial security that much easier.

As part of our *Financial Foundations* series, we have a free webinar coming up which may be helpful. On February 15th at noon ET, we are presenting *Let's Tax Taxes* for those who want a primer on the basics of our tax system. Please click here to register. This is a great resource for anyone to learn more about the basics of personal finance. Please email info@homrichberg.com to be added to the invitation list for future webinars.

To learn more or get help talking to your kids about money basics, please email me at gildea@homrichberg.com.

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