Roth IRAs for Working Kids

Ever dream about becoming a millionaire? Probably. Many teens have part-time jobs. Teens work hard for their money, and they usually earmark their earnings for short or medium-term goals, like “buying stuff” they want, getting a vehicle of their own, paying for insurance, or going to college.

For teens, it’s hard to think about life way down the road....because it seems sooooo far away! So, as a result, they’re not taking advantage of a way t0 turn their dreams of becoming a millionaire into reality. How? By opening a Roth IRA during your teenage working years and continuing to contribute to the Roth IRA during your working lifetime. *The younger you can start saving, the more your money will grow!*

What’s an IRA and What’s a Roth IRA?

IRA stands for “individual retirement account.” They are retirement accounts that people set up for themselves according to rules of Internal Revenue Service (IRS). They give people certain tax advantages to save independently for retirement.

A Roth IRA is a special kind of IRA that allows the money you save or invest to grow tax-free. It is named after Senator Roth, who first introduced the idea in the U.S. Senate several years ago. Roth IRAs differ from regular (also called traditional) IRAs in that withdrawals from a Roth IRA during retirement are **never taxed**. That’s a big advantage of a Roth IRA.

Think of a Roth IRA as a big tent. The tent provides the structure where you put your money. You can invest or save your money to fund your Roth IRA in many different ways. How you save/invest will depend on your interests, your abilities, and your risk tolerance. How you choose to save/invest will also depend on how *investment savvy* you are.

Maybe you will invest your money in **Certificates of Deposit**, or in individual **stocks**, or in **mutual funds**. You have many options. All that distinguishes your investment in a Roth IRA from a regular investment is the paperwork required to call your investment a “Roth IRA.”

Think of it this way: the name of the “tent” is the Roth IRA. The kind of savings/investment you move into the tent is your own consumer decision!

Why Should I Start Saving Now?

Because time is on your side! The younger you start saving/investing money, the more time your money has to grow. That is because of the magic of compounding. Your money makes money, and the money your money makes also continues to make money! Here's the impact:

Starting at this age	Saving for this many years	Saving $1,000 each year at 5% compounded annually, your money will grow to:
Age 10	55	$300,984
Age 15	50	$231,283
Age 20	45	$176,670
Age 25	40	$133,880
Age 30	35	$100,352
Age 35	30	$74,083
Age 40	25	$53,500

This chart shows that the earlier you start to save money, the more money you will have.

But what about becoming a millionaire, you ask? Check out financial calculators on the web to plot your own path to saving and growing a million dollars! Here's one to try: http://www.mindyourfinances.com/calculators/savings-calculator

What Kind of Job Does My Earned Income Have to Come from, and Do I Have to Keep Records?

To qualify for a Roth IRA, you must have actual *earned income* and proof that you earned it during a given year.

The money can come from any job you have, like babysitting, delivering papers, mowing lawns, or working at a restaurant or filling station, etc. If you have earned money from selling livestock or from farm or ranch work, you can benefit by saving some of it as a Roth IRA.

If you work for someone else, ask for a Form W-2 or Form 1099. These IRS forms show your earnings for the year. You may not get a form from every person you work for. Get into the habit of keeping records of all your earnings, including the tax forms mentioned above. Here's a form you can use to track your earnings. Be sure to save it with your tax files in case the IRS has questions.

My Earned Income in the Year ______		
Date of Job	**Employer's Name**	**My Earnings**

Your Consumer Decision: How Much to Save?

The example above used a contribution amount of $1,000 per year. One IRA rule states that you cannot save/invest more than you have earned during the year. So, if you earned $400, the maximum that you can save or invest in a Roth IRA is $400. You need your earnings for other things, too, so you will have to decide just how much you can afford to invest in your Roth IRA.

There may be another way around this dilemma, however. Families can help out. Some families even provide a "match" for the teen who is wanting to have a Roth IRA. Here's how it can work.

Suppose you can afford to invest $400 from your total earnings of $2,000. You are *eligible* to contribute up to $2,000 (your total earnings) .....you just can't afford to do it on your own. Your family might decide to add money to "match" yours. The "match" might be equal to yours, greater than yours, or even less than yours. *This is considered legal by the IRS, so long as the total amount contributed to the Roth IRA does not exceed your TOTAL earned income!* The source of the "match" does not matter. Maybe you are lucky enough to have a "fairy grandmother" who could help out. Birthday and graduation gifts can also be put into your Roth IRA to boost the amount as long as the total doesn't exceed either the allowable Roth limits or the amount of money you earned during the year, if what you earn is less than the Roth IRA maximum.

How Savvy Are You about Investing and Saving?

The BIG question all savers/investors have is when/where/how to save or invest their money.

Is there a difference between saving and investing? Yes, there is. When you save money, you receive certain guarantees that your money will earn interest at a particular Annual Percentage Rate (APR) for a specific time period.

Investing your money does not offer such guarantees. Investment yields, for the most part, depend on what is happening with the economy and with the financial and stock markets. The end result or success of your investments depends on many factors.

When. You may invest your money as a lump sum, but sometimes it is hard to have all of the money all at once. Also, when you invest in stocks or mutual funds, it is hard to know when the "best" time to invest arrives. Because of these reasons, financial planners recommend regular investing at regular intervals. Some months you pay more and some months you pay less to invest your money, depending upon what is happening in the stock market. On the other hand, there may be costs each time you make an investment.

Where/How. The easiest way to open a Roth IRA is with a financial institution, like a bank or credit union. Tell them you wish to designate a new Certificate of Deposit as a Roth IRA. In some cases, depending upon your age, a parent may have to co-sign the agreement.

Another popular way to open a Roth IRA is to do it with an investment company that offers investment products such as mutual funds, stocks, and bonds. Ask for the forms that must be completed to create the Roth IRA. Again, your parents may have to co-sign any agreements, depending upon your age. Check out "mutual funds" on http://finance.yahoo.com. Links will lead you to mutual fund companies, all of which have information about investment options for Roth IRAs.

If you invest your money in a mutual fund, the minimum investment amounts normally associated with such investments may be waived for IRAs.

There are many mutual funds and many stocks available in the world of investing. If you invest in a single stock, it is like putting "all of your eggs in one basket," while putting your money into a mutual fund **diversifies** your investment among many different stocks and lessens your overall risk. Many people like to put their Roth IRA money into **index mutual funds**. These funds mirror a particular segment of the overall stock market and produce returns similar to that segment; people also choose these mutual funds because of their low investment cost.

What Else Do I Need to Know?

You may fund your Roth IRA from January 1st of the calendar year until April 15the of the following year. The maximum you can contribute is $5,000 for the 2010 year, but in 2011, this limit will be adjusted for inflation. (P.S. - Just so you know - people over age 50 get to contribute an extra $1,000, so let older adults know!)

Starting early may put you on the path to becoming a millionaire! There's much more information to learn, but the information provided here will get you started!

References

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