Season 1 – Episode 15 - Securing Your Children's Future With A Roth IRA

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Host: Daniel J. Rohr, CPA/PFS, EA, M.S. Tax

Welcome to Tax Blueprints, a Rohr CPAs podcast. I'm Daniel Rohr, the managing shareholder of Rohr and Associates, a premier CPA firm based in California. I'm a CPA, personal financial specialist and enrolled agent. I have extensive experience advising individuals and business owners with tax minimization and personal financial planning strategies. On each episode of Tax Blueprints, I delve into the intricacies of tax laws, explain the subtleties of business tax planning, and guide individuals towards a path of financial stability. Whether you're a business owner navigating the murky waters of taxation or an individual planning for a worry-free retirement, Tax Blueprints will provide you with the tools and knowledge you need. I hope you enjoy this episode.

Today we're discussing a very unique and forward-thinking concept establishing a Roth IRA for your children. It's a relatively straightforward concept that can be extremely valuable. As with anything in tax, though, you need to make sure to adhere to the law to take advantage of the benefits. I will go through these in detail in this podcast. So let's get started. A Roth IRA, typically associated with individual retirement savings, can actually be an incredible tool for securing your children's financial future. First and foremost, let's discuss what a Roth IRA is. A Roth IRA is a retirement account that allows you to contribute after tax money, meaning you don't get to deduct it currently on your tax return. But when the earnings on the Roth account are withdrawn, they are tax free. There are some restrictions on this, of course, in that you must have had the Roth IRA open for at least five years, and you must be at least age 59 and a half.

Or if you're under 59 and a half, you must be using the funds for specific purposes. These are, of course, great for adults and very popular. But how can we utilize these for your kids? A Roth IRA for a child can begin as soon as they have earned income. This means if your child does small jobs for your business or elsewhere and earns money for it, they qualify. Early retirement savers are in a much better position than people who start saving for retirement at a later stage of life. Their plans can definitely still accomplish their goals, but they are required to save a much larger amount to account for the time that was lost. So starting early, especially as a child, can have huge impacts for later in life. So, for example, imagine you're starting a Roth IRA for your child at the age of four, and you contribute the maximum allowed amount of 6000 per year for 14 years until they turn 18.

Assuming a conservative 7% annual return on investment, the total contribution of $84,000 would grow to approximately $119,447 by the time they're 18. Now, let's fast forward to retirement age. If no additional contributions are made. So you're still at the $84,000 and the account continues to grow at 7% annually. The balance would soar to an astounding $2,260,000 by the age of 60. The scenario demonstrates how powerful early contributions to a Roth IRA can be, potentially securing a financially comfortable retirement for your child. In addition to these benefits, since you are paying your kids to work for you are able to of course, deduct the wages paid, which in turn saves taxes at your individual tax rate. Now, an essential aspect to dive into is the source of the income. If you're considering hiring your kids to work for your business, it's vital that you pay them appropriately for the work they are doing.

Your child must be an actual employee performing legitimate work that is suitable for their age and skill level. And the work must be a bona fide business task, meaning something that you would be able to hire an outside worker to do. You must pay your child a reasonable wage for the work they perform. This means paying them a similar amount to what you would pay a non-family employee for the same job. If your child's under 18 and works for a parent's sole proprietorship or partnership, where both parents are partners, their earnings are usually exempt from Social Security and Medicare taxes, which is known as FICA. Now, this exemption doesn't apply if the business's structure as a corporation or if only one parent is a partner. You still need to withhold federal and, if applicable, state income taxes from their pay. You must also maintain clear and detailed records of the work performed by your child, including hours worked and tasks completed.

You need to document the employee employment relationship with an official employment contract, outlining the terms of their employment. And just like any other employee, you must provide your child with a W two form detailing their earnings for the year. Your child will also need to file a tax return if they meet the income filing requirements, and depending on their income and the standard deduction for the given tax year, they most likely will not owe any income taxes. It's also advisable to make sure to comply with any child labor laws, which can vary by state. Consult with the tax professional to ensure that all the IRS requirements are met and that this strategy is suitable for your specific situation. By following these guidelines, hiring your child in your business can be a legal and financially beneficial practice. It can provide your child with valuable work experience, reduce your taxable business income, and lay the groundwork for future financial planning strategies, as well as provide a retirement safety net.

Always consult with a tax or legal professional to ensure that this strategy aligns with your family's goals and complies with all applicable laws and regulations.

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