

## **IRAs for Minors Start Saving Now**

The recent introduction of Education and Roth Individual Retirement Accounts (IRAs) provides a method for you to teach your children or grandchildren about the importance of saving money, while giving you an opportunity to save taxes. Let's take a closer look at how you can use these valuable tools.

### **Education IRAs**

An Education IRA allows money saved for college to grow tax free. Any gain on distributions from an Education IRA are federal income-tax free if used for qualified education expenses, which include tuition, fees, books, supplies and equipment related to a college level education. For students enrolled at least half-time in school, distributions for room and board are also nontaxable.

Education IRAs allow annual nondeductible contributions of up to \$500 per beneficiary per year until the beneficiary reaches age 18. To make the maximum contribution, joint donors must not have income of more than \$150,000; joint donors with income above \$160,000 cannot make any contribution. For individual donors, the phase-out begins at \$95,000 and after \$110,000, no contributions are allowed.

If your income exceeds the limits, consider making outright gifts to other relatives who do not exceed the income limit so those relatives can make Education IRA contributions they might not otherwise be able to afford. Contributions to an Education IRA qualify for the annual gift tax exclusion and may also be exempt from the generation-skipping transfer tax.

To avoid income taxes and penalties, all of the funds in the Education IRA must either be used for qualified educational expenses for the child or rolled over into an Education IRA for another family member before the original beneficiary reaches age 30. Otherwise, nonqualifying distributions from the Education IRA would need to be made to the child subject to income tax on earnings plus a 10% penalty. If the distribution was made to a child who received a scholarship, the penalty does not apply to any distributions up to the full amount of the scholarship. The penalty also does not apply if the child dies or becomes disabled.

### **Roth IRAs**

Roth IRAs can also provide tax advantages to children. Although annual contributions to a Roth IRA are not tax deductible, qualified IRA distributions are income-tax free. Qualified IRA distributions are distributions from a Roth IRA that have been held at least five years and that are made after the owner reaches age 59 1/2, dies or becomes disabled, or that are used for "qualified first-time home buyer expenses." While a teenager may not be thinking about something as distant as saving for retirement or even saving for a home, you may wish to make gifts to your children or grandchildren to allow them to contribute to a Roth IRA and get the benefit of tax-free growth.

The most obvious use of a Roth IRA for a young person is to save for a first home. The qualified first-time homebuyer distribution provisions allow an early withdrawal of \$10,000 to be applied toward the purchase of a residence. In addition, Roth IRAs allow greater access to the funds than a traditional IRA because withdrawals up to the amount of contributions are not taxable and the use of the funds is generally not restricted.

Note that your child's contribution to a Roth IRA is limited to the amount of income he or she has earned. In addition, the contributions to all IRAs for a beneficiary, including Roth IRAs, are limited to \$2,000 per individual annually. Therefore, you may find it helpful to provide your child or grandchild with a reasonable employment opportunity where he or she could earn at least \$2,000 per year.

### **It's Never Too Early**

It's never too early to start saving for your child's or grandchild's education -- or even his or her first home. Please call us if you have any questions about Education and Roth IRAs or other estate planning tools. We would be glad to discuss which may be right for you and your children or grandchildren.

### **Education IRA Contributions Add Up**

The allowable contributions may not seem like they will add up to much because they are limited to \$500 per year. This total of \$9,000 over 18 years can provide a good start on saving for a college education. In addition:

- The leverage that comes from the potential tax-free growth of the assets over a long period can result in an excellent return on the investment,
- Once a child or grandchild is attending college, apart from the Education IRA, you can make unlimited gifts to your children or grandchildren by paying the cost of qualified educational expenses directly to the college, and
- You avoid income and estate taxes that would otherwise be owed on the contributed funds.