Money Matters: Don’t let your adult children waste their youth

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How can you help your adult children build wealth when they feel broke?

You have probably already asked yourself this question: How do I help my children financially without encouraging bad habits? While you realize they would appreciate the financial help, you fear that giving them money outright may encourage future requests for handouts.

Do you wait and give it all to them as an inheritance? The answer is clear. Use modest annual gifts to help them save for retirement with a Roth IRA.

What's a Roth IRA? A Roth IRA is an individual retirement account, which allows you to deposit after-tax money into an account and the earnings are tax-free if they are withdrawn after age 59½.

Unfortunately, Congress also knows that the earnings are tax-free so they put some limits on contributions to Roth IRAs. First - your child's income must be less than $114,000 if they are single or $181,000 if they are married. Second - your child can only contribute $5,500 total per year ($6,500 if they are 50 or older).

This means that if you make the contribution on their behalf, then they cannot also make a contribution for the same tax year. Thankfully you have until April 15th of the following year to make the contribution.

You can read more about the specific rules in IRS Publication 590 or on this IRS website:

http://www.irs.gov/publications/p590/ch02.html
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Why contribute to a Roth IRA? The answer to that question is best explained in the famous quote "youth is wasted on the young." Failing to save for retirement at a young age means they are missing out on compounded earnings, which can reduce the overall amount they will need to save during their lifetime. If they wait until they can "afford" to save money for retirement then they will run into limits.

They may be earning too much to be allowed to contribute to a Roth IRA or they may need to save more than the annual amount that they are allowed to contribute into a Roth IRA. In either scenario, they will be forced to use less advantageous saving options and as a result they will regret not making their Roth IRA contributions earlier.

Now you may be asking - won't they just take the money out of the account? They might. That is a risk you should consider. However, most adult children see retirement accounts as the third rail of investment assets — look but don't touch. The IRS also feels that way. Earnings withdrawn before age 59½ are subject to tax and a 10 percent early withdraw penalty. Lastly, let your child know that if they take the money out of the account then you will stop making annual contributions on their behalf.

You may need to help your child open the account. It’s actually quite a simple process. You can contact any brokerage firm or mutual fund company for the application paperwork. Make sure to ask for the additional paperwork, which will allow you to tell the brokerage firm how to invest the money. Your child will need to sign the application but you can help them complete the rest of the forms.

A Roth IRA is not going to answer all of your money concerns for your children. You still need to help them understand the importance of living within their means. However, by helping them make these contributions early in their life, you will set them up for financial independence at a much earlier age. If you are interested in learning more about how a Roth IRA can help, then use this link to find a Certified Financial Planner close to you:

http://www.plannersearch.org/Pages/Home.aspx

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