

FAMILY WEALTH • RETIREMENT

Roth IRAs for Kids and Grandkids

How Earned Income and Decades of Compounding Create Extraordinary Outcomes

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Key Takeaways

- A child or grandchild with earned income can fund a Roth IRA, and you can gift the money to make that contribution.
- The contribution is limited to the child's actual earned income for the year, up to the annual IRA limit.
- Started early, even modest balances can grow into very large, tax-free sums by traditional retirement age, because of the sheer length of the compounding runway.
- This is one of the most powerful and underused intergenerational gifts available.

Why This Matters

Here is something most people do not know: you can gift money to your children or grandchildren, and as long as they have earned income, that money can go straight into a Roth IRA in their name. The power of this comes from time. A Roth started in childhood has an extraordinarily long runway to compound, and every dollar of that growth can come out tax-free in retirement. This paper explains how it works and the rules that govern it. It is educational, not individualized tax advice.

The Core Idea: The Power of Starting Early

The single biggest advantage a young person has is time. Consider a simple illustration. Suppose a child reaches roughly \$20,000 in a Roth IRA by age 18. Left untouched and growing at a hypothetical 10% average annual rate, that balance could grow to well over a million dollars by age 60, entirely tax-free. The exact figure depends on the return earned, which is never guaranteed, but the principle is what matters: decades of tax-free compounding turn modest early contributions into outsized results. That is the gift you can help set in motion right now.

The math isn't magic. It's time. A few thousand dollars contributed early can outgrow much larger sums contributed decades later, simply because it compounds for longer.

How It Works

A Roth IRA for a minor, sometimes called a custodial Roth IRA, is opened and managed by an adult on the child's behalf until the child reaches the age of majority. The essential requirement is earned income: the child must have actually earned money, whether from a summer job, a small business, tutoring, or similar work. The contribution for the year cannot exceed the child's earned income, up to the annual IRA contribution limit.

Importantly, the dollars contributed do not have to be the child's own. A parent or grandparent can gift the money and contribute on the child's behalf, as long as the child's earned income for the year is at least equal to the amount contributed. So a teenager who earns several thousand dollars can have a Roth funded up to that amount by a generous grandparent, while the teenager keeps the money they earned.

Why a Roth Is the Right Vehicle Here

A Roth is especially well suited to a young person. Children are typically in a very low tax bracket, so there is little benefit to the up-front deduction a traditional account offers, and a great deal of benefit to locking in tax-free growth for decades. The contributions, having already been taxed, can generally be withdrawn without tax or penalty if ever truly needed, and the long-term growth is the prize. Few financial moves combine this much simplicity with this much long-run impact.

Practical Considerations

A few things to keep in mind. The earned income must be legitimate and documentable; the IRS expects real work for real pay. Family-business arrangements can work but must be genuine and reasonable. Because the account becomes the child's when they reach the age of majority, this strategy works best alongside conversations about money and responsibility, so the account is understood as a long-term retirement asset rather than a windfall. As with any tax-advantaged account, the rules reward patience: the longer the money stays invested, the more dramatic the outcome.

The Bottom Line

Helping a child or grandchild fund a Roth IRA is one of the most powerful intergenerational gifts available, and one of the least used. The requirements are simple: earned income, an account, and the discipline to leave it alone. The reward is decades of tax-free compounding working on behalf of someone you love. If you want to understand whether and how to set this up for a child or grandchild, that is exactly the kind of planning worth a conversation.

References and Sources

The following sources support the figures, rules, and statements described in this paper. They are provided for verification and for compliance review.

Internal Revenue Service. "Retirement Topics – IRA Contribution Limits." <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits>

Internal Revenue Service. Publication 590-A, "Contributions to Individual Retirement Arrangements (IRAs)," <https://www.irs.gov/publications/p590a>

Internal Revenue Service. "Roth IRAs." <https://www.irs.gov/retirement-plans/roth-iras>

Internal Revenue Service. "Topic No. 553, Tax on a Child's Investment and Other Unearned Income." <https://www.irs.gov/taxtopics/tc553>

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