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IRAs FOR KIDS

By Victor Sy, CPA, MBA

Consider setting up individual retirement accounts (IRA) for your employed children.

Eligible individuals can make a deductible IRA contribution equal to the lesser of \$5,000 or earned income for the tax year.

A child earning an estimated \$14,500 for 2011 ends up paying no income taxes because standard deduction of \$5,800, personal exemption of \$3,650 plus IRA contribution of \$5,000 would zero out the child's income.

Since most working children use funds for living or education expenses, you can also use part of your annual \$13,000 for 2011 gift exclusion to fund the \$5,000 IRA contribution for your child, if you choose to limit your child's pay to about \$9,500. This is attractive because it enables you to remove assets from your taxable estate to your children's education or retirement. In addition, the appreciation of the transferred funds over your lifetime will not be included in your taxable estate when you die.

Funding an IRA account at age 18 instead of age 30 will result in significantly greater accumulation of savings at age 65. Assuming an 8% annual increase of savings in value, an IRA started at age 18 with yearly additions of \$5,000 could be worth a fortune for retirement at age 65.

And by the way, there is no minimum age for children to have an IRA – as long they have paychecks.

Read our related article on employing your children this summer.