CENTER FOR AGRICULTURAL PROFITABILITY
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Roth IRAs for Children Earning a Wage on the Farm

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Many farm families allow children to earn a wage from their labor. These early dollars earned are often placed in a savings or a 529 account. However, Roth Individual Retirement Accounts (IRAs) are an interesting alternative that should be considered for these funds.

What is a Roth IRA?

A Roth IRA is a retirement investment account. Investments within the account grow tax free. A "custodial" Roth IRA can be opened for a minor with a local investment advisor or online. A custodian can be a parent or another adult. Once an account is created, the custodian will need to choose the investments within the account. At age 18, the child will become the owner of the account. Roth IRAs may have fees associated with them. It is important to understand these fees before opening an account.

What are the requirements of a Roth IRA?

A single filer with an adjusted gross income under $140,000 per year, regardless of age, is eligible to contribute to a Roth IRA account.[1] Roth IRAs allow anyone with earned income, such as wages, to contribute after-tax dollars. People can contribute up to the annual limit or the total of their earned income, whichever is less.[2] The annual limit for people under age 50 is $6,000 for 2022.[3] Contributions to a Roth IRA are not tax deductible. There is no need to worry about making annual contributions as there is no mandatory funding requirement for Roth IRAs. Note that income and contribution limits adjust annually and vary based on age, and marital status. Please refer to the Internal Revenue Service (IRS) for more details.

Savings vs. 529 vs. Roth IRA

	Savings Account	529	Roth IRA
Are contributions tax deductible?	No	Yes. A Nebraska income tax deduction, up to $10,000	No
Are earnings taxable?	Yes	Yes, if not used for qualified education expenses	Yes, if withdrawn before age 59 ½ and not used for a first

[1] https://www.irs.gov/retirement-plans/plan-participant-employee/amount-of-roth-ira-contributions-that-you-can-make-for-2022
[2] https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-ira-contribution-limits
[3] https://www.irs.gov/retirement-plans/traditional-and-roth-iras

			time home purchase or qualified education expenses
Income limits to contribute?	No	No	Yes, $140,000 for single filers (2022)
Annual contribution limit?	No	No, but a $500,000 total limit per beneficiary (Nebraska)	Yes, $6,000 or annual earned income, whichever is less (2022)
Contribution withdrawal restrictions?	None	Funds should be used for qualified education expenses	None
Interest withdrawal restrictions?	None	Funds should be used for qualified education expenses	Can be withdrawn penalty-free after age 59 ½ Exceptions for first time home purchase and qualified educational expenses
Effect FAFSA?	Yes	Depends on ownership and beneficiary designations	No

A traditional place for families to put a child's earnings is in a savings account. Savings accounts are likely to have a lower rate of return when compared to a 529 or Roth IRA. Contributions to a traditional savings account are not tax deductible. Earnings on a traditional savings account may be taxable and should be reported to the IRS.[4] Additionally, a traditional savings account will be included as an asset on the Free Application for Federal Student Aid (FAFSA®) application, possibly reducing Federal Student Aid.[5]

A 529 account is a tax-advantage college savings plan. Similar to a Roth IRA, it is an investment account that is likely to earn a higher rate of return than a savings account. 529 accounts have no income limits or annual contribution limits, and anyone can contribute.[6] In Nebraska, taxpayers can deduct up to $10,000 in contributions to a 529 account from their Nebraska taxable income each year.[5] Contributions are not eligible for a federal tax deduction. Depending on the account owner and beneficiary designations, 529 accounts may have an impact on Federal Student Aid.[7]

One of the challenges of this account is that funds in a 529 account must be used for qualified education expenses. Funds used for non-qualified expenses will be penalized. If the original beneficiary does not use all of the funds in a 529 account, the beneficiary can be changed. Learn more about 529 accounts in Nebraska here: https://nest529.com/529-basics/

[4] https://www.irs.gov/taxtopics/tc403
[5] https://studentaid.gov/help/asset-net-worth
[6] In Nebraska, there is a $500,000 limit per beneficiary. https://nest529.com/tax-benefits/
[7] https://www.collegesavings.org/how-your-529-college-savings-account-affects-financial-aid/

A Roth IRA combines many of the benefits of a savings account and a 529 account. Like a savings account, a Roth IRA allows any money that is contributed to be withdrawn at any time, penalty-free. Since it is an investment account, it may accumulate additional earnings. Over the long run, it is likely that it will earn a higher rate of return than a traditional savings account. Another advantage of Roth IRAs is that they do not count as an asset for Federal Student Aid.

Earnings can be withdrawn from a Roth IRA tax free after age 59 ½. If earnings are withdrawn before age 59 ½ from a Roth IRA, those earnings may be taxed as income and charged a 10% penalty. There are two important exceptions to the earnings withdraw penalty. First, earnings can be used to pay qualified education expenses penalty free. Second, after a Roth IRA has been funded for five years, $10,000 in earnings can be withdrawn tax-free and penalty-free to buy a first home. These exceptions make Roth IRAs an attractive mechanism for young investors. With a Roth IRA, children can earn higher rates of return, have flexible funds that grow tax free, are not committing funds to a particular use and funds within the Roth IRA will not be counted as asset when applying for Federal Student Aid.

If you are not comfortable investing on your own, work closely with a Certified Financial Planner (CFP®) professional, Certified Public Accountant, tax preparer, and/or investment advisor.

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