



Working teens can maximize the power of tax-deferred — or tax-free — compounding with an IRA

Retirement is far from most teenagers' minds when they get their first jobs. Most young people are more interested in spending their earnings or saving for a shorter-term goal. But those early earnings create a significant financial opportunity: decades of potential tax-advantaged growth. Even modest contributions to an IRA now can substantially multiply over time. Moreover, a retirement account can help teens get into the habit of saving.

Traditional vs. Roth IRAs

Working teens can opt for a traditional IRA or a Roth IRA. Both offer the power of tax-advantaged compounding. For example, just \$2,000 contributed to an IRA earning 5% annually will grow to nearly \$23,000 50 years later. But there are important tax differences between the two types of IRAs:

Traditional IRA. Contributions to a traditional IRA will usually be deductible for teens. The deduction may be phased out if a taxpayer's income exceeds certain amounts and he or she (or his or her spouse) participates in a qualified retirement plan, such as a 401(k). But teenagers generally won't be affected by these limitations.

On the downside, traditional IRA withdrawals are generally taxable. In addition, a penalty applies if funds are withdrawn before age 59½ — unless an exception is available — and a larger penalty applies if required minimum distributions (RMDs)

aren't taken beginning at the age required (75 for today's teens if future legislation doesn't increase it).

Roth IRA. Roth IRA contributions are never deductible. But withdrawals — including earnings — are tax free as long as the account owner is age 59½ or older and the account has been open at least five years. In addition, *contributions* can be withdrawn at any time tax- and penalty-free. There also aren't RMDs for Roth IRAs during the original owner's lifetime.

To contribute to either a traditional or a Roth IRA, a teen must have taxable compensation, such as wages or net earnings from self-employment. For 2026, the annual contribution limit for IRAs is the lesser of taxable compensation or \$7,500. This is on a combined basis for both types of IRAs.

Typically, a parent or other adult opens a custodial IRA for a minor. The child takes control when he or she reaches the age specified under applicable state law and the account arrangement.

Roth IRA advantages

Because many working teenagers have little or no taxable income after their standard deduction is applied, a deduction for a traditional IRA contribution often provides little immediate tax benefit. As a result, a Roth IRA can be the more attractive option.

Consider Abigail, 16, who started her first part-time job at a local cafe and expects to earn \$7,500 in 2026. Her parents want to help her develop a habit of saving. They set up a Roth IRA for her because her account should have many decades to grow and qualified distributions will be tax-free.

Abigail's income is low enough that she likely will owe no federal income tax, so a current deduction for traditional IRA contributions will probably offer little, if any, benefit. Even if she does owe some tax, she'll be in the lowest bracket (10%). The potential for tax-free qualified distributions in the future is, therefore, more valuable than a deduction for a traditional IRA contribution now.

Abigail doesn't even have to use all of her own earnings to make the contribution. If she wants to contribute only \$1,500 of her earnings, her parents, grandparents or others could give her \$6,000 so she can contribute the full \$7,500 and still have \$6,000 available for spending or a shorter-term savings goal. But her family should consider any gift-tax reporting or college financial-aid implications before using this approach.

An IRA alternative

Section 530A (Trump) accounts provide another tax-advantaged savings opportunity for teens. They're similar to an IRA, but contributions don't require the child to have earned income. (The \$1,000 federal contribution you probably have heard about is limited to qualifying children born from 2025 through 2028, so today's teens aren't eligible.)

Even though, like a Roth IRA, contributions aren't deductible, the portion of distributions attributable to growth will be taxable. Also, depending on how much a working teen earns during the year, he or she may be able to contribute more to a traditional or Roth IRA. Annual contributions to a 530A account are generally limited to \$5,000, though some special contributions don't count toward that limit.

530A accounts also generally prohibit distributions and restrict investments during the growth period (until the year the child turns age 18). So a traditional or Roth IRA may offer a working teen more flexibility.

If a family can afford to contribute to both an IRA and a 530A account for a teen who's eligible for both, that may be an even more powerful savings opportunity, with potentially a combined contribution of as much as \$12,500 for 2026. But because 530A accounts were only recently enacted, IRS and Treasury guidance is still developing. Future guidance could affect the rules.

Employing your children

If your teen doesn't currently have earned income but you own a business, consider hiring him or her. Employing your child can provide the earned income needed for an IRA contribution, and you can deduct his or her pay as a business expense. The child should be old enough to handle the assigned responsibilities, perform real work and receive reasonable compensation. An excessive pay rate for routine duties could draw IRS scrutiny. Keep records of the child's duties, hours and pay.

If the business is a sole proprietorship or a partnership in which each partner is a parent of the child, wages paid to a child under age 18 *aren't* subject to Social Security and Medicare taxes. Wages paid to a child under age 21 aren't subject to federal unemployment tax. But the wages are subject to federal income tax withholding regardless of age.

If the business is a corporation, or a partnership in which not every partner is a parent of the child, the wages are subject to federal income tax withholding and Social Security, Medicare and federal unemployment taxes regardless of the child's age. That's true even if a parent controls the corporation.

Put early earnings to work

For a working teen, an IRA can provide an early start on decades of tax-advantaged saving. 2026 contributions can be made until April 15, 2027, but the income to support them must be earned by December 31, 2026.

Whether a traditional or Roth IRA is better — and how a 530A account might fit in — depends on a variety of factors. We can help you determine what fits your family's circumstances and put those early earnings to work for the future.

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