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How a gift of money can help build investing habits

As a parent or grandparent, you likely want to teach children sound money habits and help them become financially successful adults.

There are a variety of ways to instill good financial habits. The following two approaches allow you to gift assets to children while providing them with hands-on investment experience that may prove useful in the future.

1. **Custodial accounts**

   Custodial accounts can be opened for your children before they turn 18. They can be a useful vehicle to teach them about the principles of money and investing.

   With these accounts, custodians control how investments are managed. Sharing account statements and the way you make decisions on your children's behalf can be an opportunity to teach smart investment principles.

   There are a couple of considerations you will want to think about as you determine whether such an approach is right for you and your family. First, when funding these accounts, keep in mind that control of these accounts transfers to the child when the custodianship ends. This generally happens when the child reaches age 18, 19 or 21, depending on state law. You may not want your child to have control of more financial assets than they can handle at that age.

   It is also important to know that special tax rules, the "kiddie tax" rules, may apply. The income and capital gains generated in these accounts could be taxed at the parents' income-tax rates for children under age 19 (age 24 if a full-time student). This means your young child may be required to file an income-tax return of their own. Your tax advisor can help you determine how these rules would apply to your situation.

2. **Gifting money in an IRA (Individual Retirement Account)**

   Helping fund an IRA can benefit adult children who are starting their career and can’t afford to contribute to a retirement account or don't have a workplace retirement plan. Even teens with earned income can fund an IRA.

   The earlier your children start investing for retirement, the more their investments may accumulate over time. There are two types of IRA, a Traditional and a Roth.

   - Traditional IRA: If eligible, your child may receive a tax deduction when they contribute to a Traditional IRA, which will also offer tax-deferred growth potential. Any earnings from the account may grow tax free until the money is finally distributed.
   - Roth IRA: This type of account is not eligible for tax relief on the contributions, but any earnings could be distributed tax-free if taken after the Roth has been opened for more than five years and your child is aged 59½ or older. In addition, your child may be able to tap into these funds if they need them due to a disability or for use in purchasing their first home.

If you are thinking of gifting money, be sure to talk to a tax professional. Any time you give money to a child — including to a custodial account or an IRA — IRS gift rules apply.

As always, if you have any questions on this topic or any others, feel free to contact any of us at any time.

We are happy to help.

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