# Could Custodial IRAs Help Young Adults Buy Homes?

*Some parents and grandparents have that possibility in mind.*

Provided by DSA Financial Group

**Individual Retirement Arrangements (IRAs) are for retirement saving, right?** Absolutely. Is that their only purpose? Not necessarily.

**Imagine using an IRA not only to save, but to facilitate a home purchase.** This would obviously be a tall order for an adult, given current home values, yearly IRA contribution limits, and the priority of amassing retirement savings. How about for a child, though? Could an IRA help them out?

**This thought has led some families to open custodial Roth IRAs.** You can start a Roth IRA on behalf of a child, as long as that child has "earned income" (that is, income from either a W-2 job or some kind of self-employment). The IRA belongs to the child, but until the child becomes an adult, you (or some other adult) act as the IRA's custodian.[1,2]

The annual contribution limit on that Roth IRA is $6,000 (this limit may be adjusted up in future years due to inflation). Say your kid has made $4,000 from freelance web design, or serving up lattes at the local coffeehouse … or working at your business. All $4,000 could go into that IRA. That might not be the case, but whatever the amount it may benefit compound into over the next several years.[3]

You might want to consider this possible use for a Roth IRA.

**What about taxes that come with taking the money out?** After-tax dollars go into Roth IRAs, and if the account is at least five years old, up to $10,000 of the account balance (including earnings) may be withdrawn without being taxed, as long as the withdrawn amount is used for a home purchase and the IRA owner has not bought a home in the past two years. In doing this, you can even avoid the 10% tax penalty that normally comes when you take assets out of a Roth IRA before age 59½.[1,4]

**Plans may change, though.** When a child turns 18 (or 21, in some states), a custodial IRA started on his or her behalf is no longer custodial. He or she is now the legal owner of that IRA. At that time, will the idea of using those IRA funds to buy real estate in the future seem worthwhile? Maybe, maybe not.[5]

That young adult may just elect to keep contributing to the Roth IRA and use it as a retirement savings account. Or maybe the IRA is suddenly drained to enable the purchase of a new truck, or to fund a year abroad, or to pay for college. Choices will emerge, and parents and grandparents must be mindful of them. There is also the fact that when you withdraw assets from a tax-advantaged account, you are reducing not only the account balance, but also the account's potential degree of compounding for the future. These factors must be considered if you embrace this idea.

Remember that if traditional IRA distributions are taken before age 59½, they could be subject to a 10% federal income tax penalty. Also, tax rules are constantly changing, and there is no guarantee that the tax treatment of Roth (or traditional) IRAs will remain the same.

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**Citations**

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5. Business Insider, December 21, 2020