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What Kind of IRA Can You Give Your Grandkids?

Convincing a teenage grandchild to use his or her summer earnings to invest in an Individual Retirement Account (IRA) may not be easy. But it will teach your grandchild some valuable lessons — such as sacrificing a bit now for potentially greater gains down the road. But which type of IRA is better for your grandchild — a traditional IRA or a Roth IRA?

First, contributions to any type of IRA can add up. Let's say your grandchild puts $1,500 into an IRA each year for the next three years. After 50 years, the account would be worth $194,557, assuming an 8% annual return, according to Thomson Financial. That's not bad for three summers of lawn-mowing. Of course, this example is hypothetical and for illustrative purposes only, and is not meant to represent the performance of any particular product. This example also assumes no withdrawals, fees, charges or taxes, which would reduce returns. All investments involve risk, including the possible loss of principal.

Traditional IRAs offer the advantage of pre-tax contributions (assuming the contributor is not otherwise covered by an employer-sponsored retirement plan — and changes are your teenage grandchild isn't).

But for a teenager, contributing to a Roth IRA might be a more appealing IRA option. First, *contributions* (but not any earnings on or appreciation of those contributions) generally can be withdrawn at any time for any reason. That may make it a more attractive option for someone who can't imagine being alive in 50 years, let alone needing money.

Additionally, a traditional IRA may be less attractive to a teenage investor given the fact that the standard deduction for unmarried dependent children automatically shelters up to $5,350 of earned income for 2007. So unless your child earns more than the standard deduction amount this year, or has income from other sources (such as dividends and capital gains from a trust or custodial account), contributing to a traditional IRA won't generate any current tax savings.

For 2007, your grandchild can contribute the lesser of $4,000 or his or her earned income for the year.

If you'd like to help your grandkids start out right with money, we'll show you how to get them started on the right course. Give us a call.

Unusual IRA Investment Options

For most people, Individual Retirement Account (IRA) investments are pretty basic—mutual funds, or maybe some stocks and bonds. But you can get a lot more creative than that, using IRA assets to buy, well, just about anything.

Alternative IRA investments—which are permitted in any type of IRA (traditional, SEP, SIMPLE or Roth)—can potentially include stock from an initial public offering; closely held stock; real estate; options to buy real estate; oil and gas royalty interests; stock options; mortgages or other loans to be held for investment; and gold, silver, platinum, and palladium bullion (although bullion must be kept in the physical possession of your IRA trustee.) You can even hold in your IRA certain gold and silver coins minted by the United States or by any U.S. state.

In fact, just about the only investments that *aren't* allowed in IRAs are life insurance policies and certain collectibles, such as art, rugs, antiques, gems, stamps, and coins.

The primary benefit of an alternative IRA investment is diversification. Although diversification can't protect against a loss, having a variety of investment types could help you weather the ups and downs of different asset classes and obtain an overall return with which you are comfortable.

That's not to say using your IRA to buy, say, bullion is a good idea. Many alternative investment options are illiquid, which can cause problems, especially for those nearing or in retirement. If your IRA is invested in assets you can't easily sell, you might not be able to get cash from your IRA when you need it. And that means you might not be able to take your required minimum distributions (RMDs), if applicable to your circumstances. That's bad news, because the IRS can penalize you for 50 percent of the difference between what you should have withdrawn from your IRA each year and what you actually did withdraw.

If you've considered the pros and cons of alternative IRA investments, and still think they might be suitable for you, you'll need to find an IRA trustee willing to help you invest your IRA in something other than mutual funds, stocks, or bonds. And that may be challenging, because what is and isn't allowed by the IRS can get pretty vague, and many trustees simply don't want the hassle of figuring it out. Plus, it takes more time to complete a real estate transaction than to purchase stocks or bonds, making it potentially less profitable for a trustee.

But some trustees actually specialize in IRAs that hold alternative investments, which are sometimes referred to as "self-directed" IRAs. You may be able to find such a trustee by doing an Internet search for "self-directed IRA."

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Note that all of the above mentioned alternative investments in self directed IRAs entail risk and may result in gain or loss. Self directed IRAs may carry annual fees, handling fees for certain investments or transactions fees. Each selection incurs transaction expenses and commissions and potential other costs including management fees or liquidation costs. Additionally, investments such as real estate or loans will be illiquid and could create problems if distributions are required. Withdrawals from IRAs are taxed as ordinary income and will incur a 10% penalty if made prior to age 59 ½. Certain investments could cause unrelated business taxable income. This article is not intended to provide tax or legal advice and should not be relied upon as such. It is a summary of our understanding and interpretation of some of the current laws and regulations and is not exhaustive. Investors should consult their legal or tax advisor for advice and information concerning their particular circumstances.

◆As federal and state tax rules are subject to frequent changes, you should consult with a qualified tax advisor prior to making any investment purchase decisions.

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