A Roth IRA Is a Smart Move for Young Workers. Here's Why.

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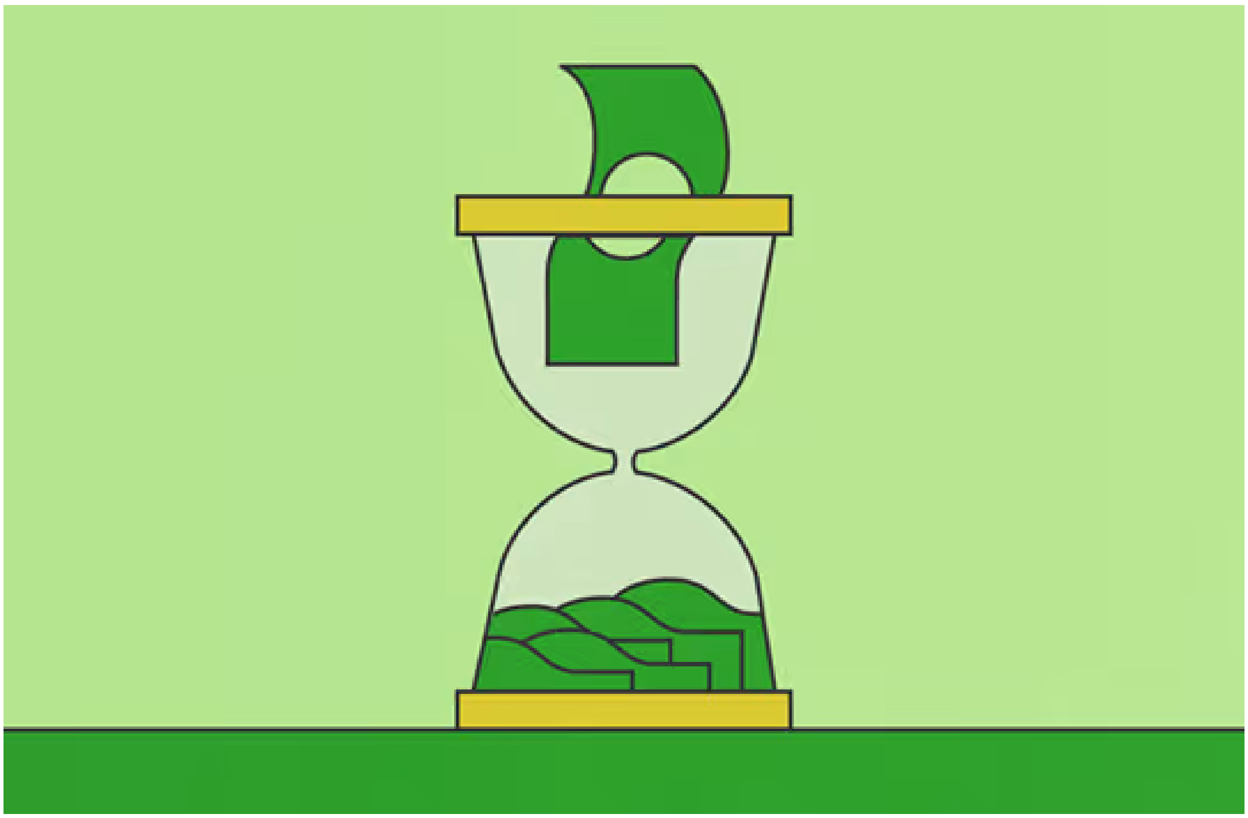

For a young investor, a Roth individual retirement account can provide decades of tax-free growth. ILLUSTRATION BY BARRON'S

Carlee Migliorisi, a 21-year-old student at New Jersey's Monmouth University, is already saving for retirement. She learned about Roth individual retirement accounts on Instagram, opened one and made the maximum contribution of $6,000 both in 2021 and 2022.

"I'm not sure where life will take me," Migliorisi says. "But in the back of my mind, I know the Roth will be there for when I retire from whatever job I end up choosing."

Investing in a Roth individual retirement account while you are young and in a low tax bracket Investing is a smart move, advisors say. Savers can use these vehicles to squirrel away posttax money, watch it grow for decades and eventually withdraw it tax-free—or leave it to their heirs tax-free.

While Roths are particularly advantageous for people who will be in a higher tax bracket when they withdraw the money—a situation that is often impossible to predict—young investors are likely to benefit regardless because they will get so many years of tax-free growth. A $7,000 investment, the maximum Roth IRA contribution allowed for people under age 50 in 2024, would grow to more than $100,000 during 40 years in the market assuming a 7% rate of return after inflation.

“It is the best retirement play,” says Jorie Johnson, the certified financial planner in Brielle, N.J., who helped Migliorisi open her account. Johnson recommends that all young people invest in a Roth IRA as soon as they are earning money, even if they can only contribute $100. Tax treatment

Young investors are typically paying a low tax rate on the money they put into Roth IRAs, especially if they are high school or college students working part time jobs or in the early stages of their career. Once that money is invested, they never have to pay taxes on it again.

“If you’re 20 years old and you’re not going to retire for at least 40 years, that’s a ton of time for tax-free growth,” says Michelle Crumm, certified financial planner in Ann Arbor, Mich. “If that’s growing into $1 million and you’re pulling it out and not paying any taxes on it, that’s beautiful.”

Decades from now if this investor wants to buy a new condo to retire in, for instance, they can tap their Roth IRA instead of a taxable brokerage account. That means investing in a Roth IRA now could save them from paying capital-gains taxes down the road, Crumm points out.

Income limits

Young people may lose the ability to fund Roth IRAs as their careers take off. Single tax filers can only contribute to a Roth IRA if their income is below $161,000 in 2024 while married taxpayers filing jointly can earn no more than $240,000, according to the IRS

.

That's why Johnson recommends that once young people get their first jobs, they continue to invest in a Roth IRA alongside any employer-sponsored retirement accounts like a 401(k).

"If we can get them to put something in a Roth or max it out in the first five or 10 years of their working career, it's the best long-term option for them as far as bang for your buck," Johnson says.

The good news is that more employers are offering Roth 401(k)s, giving all workers the option of funding a Roth instead of a tax-deferred account.

Access to your money

Locking money up until their golden years may make a young worker hesitant. But unlike with a traditional tax-deferred IRA or 401(k), Roth IRAs allow you to withdraw your contributions before turning age 59 1⁄2 without penalty.

Earnings on those contributions are a different story. If you withdraw earnings before age 59 ½ and before the account is five years old, those earnings may be subject to taxes and penalties, depending on what the withdrawal is used for. If you withdraw earnings after age 59 ½ but before the account is five years old, those earnings may be subject to taxes but not penalties.

If an emergency arises, someone with a Roth IRA would be able to tap at least some of the money in the account without having to worry about taxes and penalties.

“It’s much better to leave [the money] there and let it compound for decades,” Johnson says. “But it is available.”

That’s what a Roth IRA gives young investors in general: flexibility. Crumm says her clients who have a balanced retirement savings strategy which can include a tax-deferred 401(k), a taxable brokerage account and a Roth IRA—typically have more freedom financially later in life.

Having those options is why Migliorisi is happy with her decision.

“People my age are still testing the waters of what they want to do with their lives,” she says. Whether or not the job she ends up choosing comes with a pension or retirement savings benefits, “I’ll still have that Roth IRA in my back pocket.”