How a Roth IRA Works

By Viplav Nigam, Founder, LongShort.io



ALEX

Sam, I have fifty dollars left from my first bakery paycheck. Could I put that away for when I’m older?

SAM

Sure. How soon might you need it?

Money for later



ALEX
Bus pass, groceries, a little extra for surprises. I’ve set those aside. The fifty can wait.

SAM
Then let’s look at a Roth IRA. It’s a retirement account you can open for yourself, even at nineteen.

Where do I open one?



SAM
Look for “Roth IRA” at a brokerage. Before you choose one, check its fees, minimums and investments.

ALEX
I opened the account. Now I link my bank, choose 2026 as the contribution year and transfer my $50?

SAM
Right. Your bakery wages count as earnings for that year.

What did my $50 buy?



ALEX
It says “cash available to invest.” I thought I just bought a Roth.

SAM
You put money in the account. Now you can choose what to own inside it.

ALEX
Oh! I could look for a Treasury bill in here, too, if I had enough to buy one.

Choosing what goes inside



ALEX
This broad stock index fund holds pieces of lots of companies. Can I buy $50 worth?

SAM
This provider allows it. Check what the fund owns and its annual fee. Its value can fall, even when you own a little of many companies.

ALEX
I place the order. Now the fund shows up under holdings.

Why use a Roth?



ALEX
I could own that same fund in an ordinary account. Why put it here?

SAM
You get no tax deduction for this $50. In return, if you meet the Roth rules, you can take out the investment earnings tax-free in retirement.

ALEX
So I choose the investment. The Roth rules tell me how the gains are taxed.

What can time do with $50?

Alex turns over her napkin. Suppose her fund gains 5% in a year and she leaves everything invested.

After one year • $52.50

Five percent of $50 is $2.50.

After two years • about $55.13

The second year’s 5% applies to the full $52.50. Her earlier gain can earn a return of its own. That is compounding.

After forty years • about $352

That is one $50 contribution growing at a hypothetical 5% each year. Actual returns vary, losses are possible, and inflation affects what those dollars can buy.

Alex folds up the napkin. “Next payday, I’ll see what I can spare. At least now I know what happens after I press transfer.”

Before your first contribution

How much can I put in?

For 2026, someone under 50 generally can contribute up to the smaller of $7,500 or their eligible taxable compensation, across traditional and Roth IRAs combined. If Alex earns $2,000 all year, her usual limit is $2,000. Income and filing status can further reduce direct Roth eligibility.

What if I’m under eighteen?

A provider offering custodial Roth IRAs can help an adult open and manage one for a minor who has eligible earnings. The young person owns it. A birthday gift alone does not count as earnings.

When can I take money out?

Under federal rules, regular contributions generally come out first, tax- and penalty-free. For tax-free earnings in ordinary retirement, reach age 59½ and satisfy the five-tax-year rule, starting January 1 of the first tax year for which you contributed to any Roth IRA. Earlier earnings withdrawals can trigger tax and a 10% additional tax, subject to exceptions.

IRS • IRA contribution limits
IRS • Publications 590-A (contributions)
590-B (withdrawals and exceptions)
Investor.gov • Investment products
Fidelity • Custodial Roth IRA example