COVERDELL EDUCATION SAVINGS ACCOUNT

DEFINITION:

A Coverdell Education Savings Account may be created for the purpose of paying the qualified education expenses of a designated beneficiary.

(A) Contributions

Annual contributions are limited to $2,000 per beneficiary per year and the beneficiary must be under the age of 18 (except in the case of a special needs child). The $2,000 annual contribution limit is phased out ratably for individual taxpayers with modified AGI between $190,000 and $220,000. Contributors with AGI above these ranges are not allowed to make contributions. The $2,000 limit is per year and per beneficiary. So grandfather contributes 1,500 towards a child account, grandmother is limited to $500. Excess contributions are subject to a 6% penalty.

(B) Taxation

Contributors to an ESA are not income tax deductible, but earnings will grow tax-deferred.

Contributions are considered complete present interest gifts. Qualified withdrawals will be tax-free

(C) Distributions

When the funds are distributed to pay the qualified education expenses, neither principal nor earnings will be taxed. Qualified education expenses include elementary and secondary school tuition, expenses of special needs beneficiaries, post-secondary tuition, fees, books, supplies, uniforms, equipment, and certain room and board expenses. The earnings portion of any distribution that is not used to pay for qualified education expenses is taxed to the beneficiary and is also subject to an additional 10% penalty tax. In this case earnings mean any growth in excess of contributions.

(D) Other Credits

A taxpayer may claim a Hope Scholarship credit or Lifetime Learning credit for the same taxable year that there are distributions from an ESA account as long as they are used to pay for different costs.

(E) Balance Not Distributed

Any balance remaining in an ESA account at the time a beneficiary becomes 30 years old (except for a special needs) or dies must be distributed. the earning portion of such a distribution will be included in gross income of the beneficiary and subject to a 10% penalty because the funds were not used for educational purposes. However, it is possible to avoid taxation by rolling the account over to another ESA for the benefit of a different beneficiary, in the same family and has not attained age 30.