Coverdell Education Savings Accounts

Every parent looks at their child and wonders what the future holds.

- What jobs will be available?
- What kind of training will my child need— college or technical school?
- Will the money be there for their education?

You may not know the answer to the first two questions, but a Coverdell education savings account (ESA), can help you with the last answer. The following information is provided to help answer some common questions on Coverdell Education Savings Accounts. Citizens State Bank advises you to seek advice from a tax professional for information pertaining to your own individual needs.

What is a Coverdell education savings account (ESA)?

An ESA is just that—a savings arrangement in which contributions are invested for the purpose of funding an individual's education. ESA contributions are not tax-deductible, but the contributions may earn interest tax deferred until distributed, and the child will not owe tax on any withdrawal from the account if withdrawal is equal to or less than the child's qualified education expenses at an eligible educational institution for the year. Amounts withdrawn from an ESA that exceed the child's qualified education expenses in a taxable year may be subject to income tax and to an additional penalty of 10 percent. If the child does not need the money for pre- or postsecondary education, the child may roll or transfer the account balance to an eligible family member's ESA or to a qualified tuition program (QTP).

Who is a designated beneficiary?

A designated beneficiary of an ESA is the person on whose behalf the ESA has been established.

What is the contribution limit?

Eligible taxpayers may deposit up to $2,000 per year into a Coverdell ESA for a child under the age of 18. Parents, grandparents, other family members, friends, and even the designated beneficiary of the ESA (child) may contribute to an ESA for the same child, but the total contributions for a child for a taxable year cannot exceed $2,000. Eligible taxpayers may contribute up to $2,000 for multiple children in a year, however.

Who can contribute to a Coverdell Education Savings Account?

The answer to that question is almost anyone.

- Individuals of any age
- Individuals without earned income
- Individuals with modified adjusted gross income (MAGI) within the applicable limits for their filing status
- Any corporation or other entity (including tax-exempt organizations) irrespective of income limits

There are two key limitations:

- Each child can receive a total of the maximum allowed per year in contributions from all sources. It does not make a difference if this is done in a single account or multiple accounts designed to benefit the same child.
- The income limit for making a maximum contribution now stands at $190,000 for married couples filing joint tax returns, and contributions phase out at $220,000 in 2009 and 2010. For those not filing a joint return or for single tax filers, the contribution limit is $110,000.

What is a qualified education expense?

A qualified elementary, secondary or higher education expense is one that is required for the enrollment or attendance by your child at an eligible educational institution.

These expenses include the following.

- Tuition
- Fees
- Books
- Supplies
- Equipment
- Academic tutoring
- Special needs services
- Room and board expenses
- Uniforms
- Transportation
- Educational computer technology or equipment
- Internet access

Can I move assets between Coverdell education savings accounts?

You can move assets from one ESA to a new or existing ESA through a transfer (direct) or a rollover (indirect). With either type of movement the funds, however, must benefit the same child or an eligible member of the child's family. A rollover or a transfer contribution does not affect the annual contribution limit. Rollovers must be completed within 60 days of the initial distribution and are limited to one per 12-month period.

Can I roll over other assets into a Coverdell education savings account?

The Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 contains tax relief for military personnel and their beneficiaries. One such tax relief provision allows a beneficiary who receives a military death benefit gratuity or a Servicemembers' Group Life Insurance payment to contribute (as a rollover) up to the full amount to a Coverdell ESA (or a Roth IRA) without taxation.

Am I allowed to change the beneficiary?

The responsible individual may change the designated beneficiary (child). Someone may wish to change the beneficiary if the current beneficiary has completed their education and funds remain. The only requirement is that the new beneficiary must be an eligible member of the family.

Who is an eligible member of the family?

All of the following are possible family members that may be renamed as ESA beneficiaries.

- Children, grandchildren, stepchildren, and foster children of the designated beneficiary
- Brothers, sisters, stepbrothers, stepsisters, half-brothers, and half-sisters of the designated beneficiary
- Nephews and nieces of the designated beneficiary
- Parents and stepparents of the designated beneficiary In-laws of the designated beneficiary (son, daughter, brother, sister, father, mother)
- Uncles and aunts of the designated beneficiary
- Spouses of all the family members listed above
- First-cousin of the designated beneficiary

Even with this extended range of family members, contributions can be made only for those under the age of 18, or for individuals with special needs beyond age 18.

How does the age waiver for a special needs beneficiary work?

Designated beneficiaries with special needs are eligible to:

- receive annual contributions after attaining age 18.
- keep ESA assets in an ESA after attaining age 30.
- receive rollover contributions from qualified family members after attaining age 30, and
- be named as a designated beneficiary to a qualified family member's ESA after attaining age 30.

What is the contribution deadline?

The deadline to contribute to an ESA for a tax year is the tax return due date not including extensions (i.e., April 15). When this date occurs on a weekend or a legal holiday, you have until the following business day to make a contribution. A contribution made between January 1 and April 15 for the previous tax year is referred to as a "carryback contribution".

For more information...

For more information about paving the road to success for your child, please ask one of our representatives for more details. Our representative may also suggest that you seek advice from a competent tax advisor.