

**WHAT IS A COVERDELL EDUCATION SAVINGS ACCOUNT?**

A Coverdell Education Savings Account (formerly known as an Education IRA) is a trust or custodial account created exclusively for the purpose of paying the qualified education expenses of an individual who is a "designated beneficiary". A "designated beneficiary" is generally defined as a child under the age of 18. Distributions from a Coverdell Education Savings Account are tax-free if used to pay the education expenses of the child.

**WHO MAY ESTABLISH A COVERDELL EDUCATION SAVINGS ACCOUNT?**

A Coverdell Education Savings Account may be established by a "contributor" who makes contributions on behalf of a "designated beneficiary" (child). A contributor is not required to have compensation or to be related to the child and may even be the child. Beginning in 2002, corporations and other entities, including tax exempt organizations, are permitted to make contributions on behalf of the child.

Contributions are not tax deductible by the contributor, but distributions are generally tax free if such distributions are used to pay qualified education expenses of the child.

Contributions must be made in cash and cannot exceed \$2,000 (for 2002 contributions) per child on an annual basis. Contributions may not be made after the date the child attains the age of 18.

Also effective in 2002, contributions may be made to a Coverdell Education Savings Account in the same year contributions are made to a Qualified State Tuition Program on behalf of the same child.

**WHAT IS THE DEADLINE FOR CONTRIBUTING TO A COVERDELL EDUCATION SAVINGS ACCOUNT?**

Beginning for contributions made for 2002 and subsequent years, the contribution for a year must be made no later than the contributor's tax filing deadline for the contribution year, not including extensions. This will generally be April 15<sup>th</sup>.

**HOW MUCH MAY I CONTRIBUTE?**

The maximum contribution limit is \$2,000 per child for a taxable year. This \$2,000 maximum is phased out depending upon the filing status and modified adjusted gross income (MAGI) of the contributor, unless the contributor is an entity. The phase out limits are as follows:

<i>Individual Taxpayers:</i>		
MAGI of \$95,000 or Less:	MAGI between \$95,000 and \$110,000	MAGI of \$110,000 or More:
\$2000 Contribution	Partial Contribution	No Contribution
<i>Married Taxpayers Filing Jointly:</i>		
MAGI of \$190,000 or Less:	MAGI between \$190,000 and \$220,000	MAGI of \$220,000 or More:
\$2000 Contribution	Partial Contribution	No Contribution

The following examples describe this limitation.

*Example 1* - Susan, a married taxpayer who files jointly with her husband has Modified AGI of \$205,000. The maximum contribution that Susan could make to a Coverdell Education Savings Account on behalf of any one child would be \$1,050 determined as follows:

\$220,000	(phase out threshold)
<u>-205,000</u>	(minus MAGI)
\$ 15,000	
<u>X .07</u>	(\$ .07 offset per dollar of MAGI over \$190,000. This was determined by dividing \$2,000 by \$30,000)
\$ 1,050	(maximum contribution by Susan on behalf of one child)

*Example 2* - John, an individual taxpayer would like to establish a Coverdell Education Savings Account for his nephew. John's Modified AGI is \$90,000. Since John's MAGI is less than \$95,000, the maximum \$2,000 may be contributed to a Coverdell Education Savings Account for his nephew.

*Example 3* - Mary, an individual taxpayer has 3 children. Her Modified AGI for the year is \$97,000. The total contribution permitted to a Coverdell Education Savings Account for each child is \$1,690 determined as follows:

\$110,000	(phase out threshold)
<u>- 97,000</u>	(minus MAGI)
\$ 13,000	
<u>X .13</u>	(this offset was determined by dividing \$2,000 by \$15,000)
\$1,690.00	

**WHO CONTROLS THE ACCOUNT?**

When the Coverdell Education Savings Account is established, a "responsible individual" must be named. Generally, the responsible individual must be a parent or legal guardian of the child. This responsible individual will make all decisions regarding the account, such as directing investments and requesting distributions.

**WHAT ARE QUALIFIED EDUCATION EXPENSES?**

Qualified Education Expenses include tuition, fees, academic tutoring, special need services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the child at a public, private or religious school providing elementary, secondary or post secondary education. Expenses also include room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such school in connection with such enrollment or attendance of the child. The purchase of any computer technology or equipment to be used by the child during any of the years that the child is in school may also be considered an education expense.

Qualified Education Expenses also include qualified higher education expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the Designated Beneficiary at an eligible educational institution. These expenses include room and board if the Designated Beneficiary is at least a half-time student.

Qualified Education Expenses also include amounts paid or incurred to purchase tuition credits or certificates, or to make contributions to an account under a qualified state tuition program for the benefit of the child.

Qualified Education Expenses are reduced by amounts provided by scholarship, educational assistance allowance, or any other payment (other than a gift or bequest) which is excludable from gross income under any law of the U.S.

**WHAT IS AN ELIGIBLE EDUCATIONAL INSTITUTION?**

An Eligible Educational Institution includes post-secondary institutions offering credit toward a bachelor's degree, an associate's degree, a graduate level or professional degree, or other recognized post-secondary credentials. This includes Colleges, Universities and Vocational schools. The institution must be eligible to participate in the Department of Education Student Aid Programs.

Beginning in 2002, an Eligible Educational Institution also includes kindergarten through grade 12, as defined by state law. The school may be either a public, private or religious school.

**MAY THE DESIGNATED BENEFICIARY BE CHANGED?**

Yes. Depending upon the terms of the specific Coverdell Education Savings Account agreement, you may generally

change the designated beneficiary of the Coverdell Education Savings Account from the original child to a new designated beneficiary, so long as the new beneficiary is a family member of the original child and has not attained the age of 30.

The change of designated beneficiary under a Coverdell Education Savings Account is not treated as a distribution.

#### **HOW ARE DISTRIBUTIONS TAXED?**

If the distribution is equal to or less than the Qualified Education Expenses on behalf of the child, then no portion of the distribution is included in gross income of the designated beneficiary.

Beginning in 2002, tax-free distributions from a Coverdell Education Savings Account are also permitted for any year that the Hope Scholarship Credit, the Lifetime Learning Credit, and/or an expense deduction under §162 is taken with respect to qualified higher education expenses on behalf of the designated beneficiary.

If the distribution is greater than the expenses or is for noneducation purposes, a portion of the distribution will be includible in the gross income of the designated beneficiary and a 10% additional income tax may apply to the taxable amount.

#### **WHAT HAPPENS IF TOO MUCH IS CONTRIBUTED?**

Excess contributions to a Coverdell Education Savings Account are amounts which exceed \$2,000 deposited on behalf of a child for the same year and are subject to a 6% excise tax until corrected by distribution. However, this 6% penalty does not apply if the excess plus earnings is returned to the child before May 31<sup>st</sup> of the year following the calendar year during which the excess was made.

#### **ROLLOVER CONTRIBUTIONS**

A Coverdell Education Savings Account may be rolled over into another Coverdell Education Savings Account for the benefit of the same child or that of another family member of the child. Such family member must be under the age of 30. This rollover must be completed no later than the 60th day after the date of the distribution. No more than one such rollover may be made in a 12 month period.

A family member generally means an individual who bears a relationship to the child and includes the spouse, children, grandchildren, siblings, parents, nieces, nephews or in-laws of the child.

#### **WHAT HAPPENS IF THE CHILD DIES?**

Upon the death of the child, the balance in the Coverdell Education Savings Account will generally be paid to the child's estate, unless a new designated beneficiary (meeting the definition of family member) is named within 30 days after death.

Depending upon the terms of the specific Coverdell Education Savings Account agreement, if there was a death beneficiary designated, such beneficiary will receive the assets and if such death beneficiary is a family member, the assets may be rolled to a Coverdell Education Savings Account with the death beneficiary as the designated beneficiary.

#### **SPECIAL NEEDS CHILDREN**

In general, contributions may not be made after the child attains the age of 18. An exception applies in the case of a special needs child. (A special needs child is defined by the IRS.) Also, a special needs child does not need to receive a full distribution of the account by age 30 as discussed below.

#### **MISCELLANEOUS REQUIREMENTS**

Any balance in the account on the date the designated beneficiary attains age 30 must be distributed to the designated beneficiary (or rolled over to a Coverdell Education Savings Account of another family member) within 30 days of such date.

No part of the assets may be invested in life insurance contracts. The assets may not be commingled with other property except in a common trust fund or common investment fund. Prohibited transactions include borrowing from the account or pledging the account as security for a loan.

Contributions to a Coverdell Education Savings Account are reported to the IRS by the financial institution on Form 5498. Distributions from the account are reported by the financial institution on Form 1099-R. IRS Form 8606 is filed by the designated beneficiary to figure taxable distributions from the account. A worksheet is provided in the Form 8606 instructions to keep track of contributions made in order to properly calculate any taxable distributions.

*Our retirement specialists are ready to help you. Call today for more information on the Coverdell Education Savings Account.*

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