

## CREDIT UNION COVERDELL ESA DISCLOSURE STATEMENT (rev. 9/2003)

Beginning January 1, 2002, taxpayers may deposit up to \$2,000 per year into a Coverdell Education Savings Account (ESA) for a child under age 18. Parents, grandparents, other family members, friends, and a child him/herself may contribute to the child's Coverdell ESA, provided that the total contributions for the child during the taxable year do not exceed the \$2,000 limit. Amounts deposited in the account grow tax-deferred until distributed, and the child will not owe tax on any withdrawal from the account if the child's qualified education expenses paid during the year equal or exceed the amount of the withdrawal. If the child does not need the money for education, the account balance can be rolled over to the Coverdell ESA of certain family members who can use it for their education. A portion of amounts withdrawn from a Coverdell ESA that exceed the child's qualified education expenses in a taxable year is subject to income tax and to an additional tax of 10 percent.

### **Q1: What is a Coverdell ESA?**

A1: A Coverdell ESA is a trust or custodial account that is created or organized in the United States exclusively for the purpose of paying the qualified education expenses of the Designated Beneficiary of the account. The account must be designated as a Coverdell ESA when it is created in order to be treated as a Coverdell ESA for tax purposes.

### **Q2: For whom may a Coverdell ESA be established?**

A2: A Coverdell ESA may be established for the benefit of any child under age 18. Contributions to the Coverdell ESA will not be accepted after the Designated Beneficiary reaches his/her 18th birthday. The IRS is authorized to issue regulations allowing contributions after age 18 for special needs beneficiaries.

### **Q3: Where may an individual open a Coverdell ESA?**

A3: An individual may open a Coverdell ESA with any bank, or other entity that has been approved to serve as a nonbank trustee or custodian of an individual retirement account (IRA), and the bank or entity is offering Coverdell ESAs.

### **Q4: How much may be contributed to a child's Coverdell ESA?**

A4: Up to \$2,000 per year in aggregate contributions may be made for the benefit of any child. The contributions may be placed in a single Coverdell ESA or in multiple Coverdell ESAs. Contributions prior to 2002 were subject to a \$500 per year limit.

### **Q5: When can Coverdell ESA contributions be made for a child?**

A5: Regular contributions can be made to a Coverdell ESA for a year up until the time prescribed by law for filing the tax return for that year (excluding extensions). If a calendar tax year is used, the deadline for making a regular Coverdell ESA contribution is April 15 of the following year. If April 15 is a weekend or a legal holiday, then the deadline is the next business day. A contribution can be made on or before this deadline, even if the tax return has already been filed for the tax year. In such a situation, an amended return should be filed on IRS Form 1040X to reflect the contribution.

There is no special time during this period for making a contribution. Contributions may be made periodically throughout the year, or in a single contribution for the year.

### **Q6: What happens if more than \$2,000 is contributed to a Coverdell ESA on behalf of a child in a calendar year?**

A6: Aggregate contributions for the benefit of a particular child in excess of \$2,000 for a calendar year are treated as excess contributions. If the excess contributions (and any earnings attributable to them) are not withdrawn from the child's account (or accounts) by May 31 of the year after the year for which the contributions were made, the excess contributions are subject to a 6 percent excise tax for each year the excess amount remains in the account. The May 31 deadline is extended to October 15 if the Designated Beneficiary timely filed an income tax return for the year and correctly reports the contributions and the withdrawal.

### **Q7: May contributions other than cash be made to a child's Coverdell ESA?**

A7: No. Coverdell ESAs are permitted to accept contributions made in cash only.

### **Q8: May contributors take a deduction for contributions made to a Coverdell ESA?**

A8: No.

### **Q9: Are there any restrictions on who can contribute to a Coverdell ESA?**

A9: Any individual may contribute up to \$2,000 to a child's Coverdell ESA if the individual's modified adjusted gross income for the taxable year is no more than \$95,000 (\$190,000 for married taxpayers filing jointly). The \$2,000 maximum contribution per child is gradually reduced for individuals with modified adjusted gross income between \$95,000 and \$110,000 (between \$190,000 and \$220,000

for married taxpayers filing jointly). For example, an unmarried taxpayer with modified adjusted gross income of \$96,500 in a taxable year could make a maximum contribution per child of \$1,800 for that year. Taxpayers with modified adjusted gross income above \$110,000 (\$220,000 for married taxpayers filing jointly) cannot make contributions to anyone's Coverdell ESA.

### **Q10: May a child contribute to his/her own Coverdell ESA?**

A10: Yes.

### **Q11: Does a taxpayer have to be related to the Designated Beneficiary in order to contribute to the Designated Beneficiary's Coverdell ESA?**

A11: No.

### **Q12: How many Coverdell ESAs may a child have?**

A12: There is no limit on the number of Coverdell ESAs that may be established designating a particular child as beneficiary. However, in any given taxable year the total aggregate contributions to all the accounts designating a particular child as beneficiary may not exceed \$2,000.

### **Q13: May a Designated Beneficiary take a tax-free withdrawal from a Coverdell ESA to pay qualified education expenses if the Designated Beneficiary is enrolled less than full-time at an eligible educational institution?**

A13: Yes. Whether the Designated Beneficiary is enrolled full-time, half-time, or less than half-time, he/she may take a tax-free withdrawal to pay qualified education expenses.

### **Q14: What happens when a Designated Beneficiary withdraws assets from a Coverdell ESA to pay educational expenses?**

A14: Generally, the withdrawal is tax-free to the Designated Beneficiary to the extent the amount of the withdrawal does not exceed the Designated Beneficiary's qualified education expenses.

### **Q15: What are "qualified education expenses"?**

A15: "Qualified education expenses" mean qualified elementary and secondary education expenses (Q&A16) and qualified higher education expenses (Q&A17).

## CREDIT UNION COVERDELL ESA DISCLOSURE STATEMENT (continued)

### **Q16: What are "qualified elementary and secondary education expenses"?**

A16: Qualified elementary and secondary education expenses are the total of:

- (1) expenses for tuition, fees, academic tutoring, books, supplies, equipment and special needs services (for a special needs beneficiary) incurred in connection with enrollment or attendance of the Designated Beneficiary as an elementary or secondary school student at a public, private, or religious school as determined under state law;
- (2) expenses for room and board, uniforms, transportation, and supplementary items and services (e.g., extended day programs) required or provided by a school in connection with enrollment or attendance; and
- (3) purchase of computer technology or equipment or Internet access to be used by the beneficiary and his or her family while the beneficiary is in elementary or secondary school, except this does not include software for sports, games or hobbies unless the software is predominantly educational.

### **Q17: What are "qualified higher education expenses"?**

A17: Qualified higher education expenses are the expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the Designated Beneficiary at an eligible higher educational institution.

Qualified higher education expenses also include amounts contributed to a qualified state tuition program.

Qualified higher education expenses also include room and board (generally the school's posted room and board charge, or \$2,500 per year for students living off-campus and not at home) if:

- (1) for at least one academic period (e.g., semester, trimester, quarter) beginning during the calendar year, the student is enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential, and
- (2) the student is free of any conviction for a Federal or State felony offense consisting of the possession or distribution of a controlled substance.

A student will be considered to be enrolled at least half-time if the student is enrolled for at least half the full-time academic workload for the course of study the student is pursuing as determined under the standards of the institution where the student is enrolled. The institution's standard for a full-time workload must equal or exceed the standards established by the Department of Education under the Higher Education Act and set forth in 34 C.F.R. section 674.2(b).

An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution that is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) and, therefore, eligible to participate in the student aid programs administered by the Department of Education. This category includes virtually all accredited public, nonprofit, and proprietary postsecondary institutions. (The same eligibility requirements for institutions apply for the Hope Scholarship Credit, the Lifetime Learning Credit, and early withdrawals from IRAs for qualified education expenses.)

### **Q18: What happens if a Designated Beneficiary withdraws an amount from a Coverdell ESA but does not have any qualified education expenses to pay in the taxable year he/she makes the withdrawal?**

A18: Generally, if a Designated Beneficiary withdraws an amount from a Coverdell ESA and does not have any qualified education expenses during the taxable year, a portion of the distribution is taxable. The taxable portion is the portion that represents earnings that have accumulated tax-deferred in the account. The taxable portion of the distribution is also subject to a 10 percent additional tax unless an exception applies.

### **Q19: Is a distribution from a Coverdell ESA taxable if the distribution is contributed to another Coverdell ESA?**

A19: Any amount distributed from a Coverdell ESA and rolled over to another Coverdell ESA for the benefit of the same Designated Beneficiary or certain members of the Designated Beneficiary's family is not taxable. An amount is rolled over if it is paid to another Coverdell ESA on a date within 60 days after the date of the distribution. Members of the Designated Beneficiary's family include the Designated Beneficiary's children and their descendants, stepchildren and their descendants, siblings and their children, parents and grandparents, stepparents, and spouses of all the foregoing. The \$2,000 annual contribution limit to Coverdell ESAs does not apply to these rollover contributions.

For example, an older brother who has \$5,000 left in his Coverdell ESA after he graduates from college can roll over the full \$5,000 balance to a Coverdell ESA for his younger sister who is still in high school without paying any tax on the transfer.

### **Q20: What happens to the assets remaining in a Coverdell ESA after the Designated Beneficiary finishes his/her postsecondary education?**

A20: There are two options. The amount remaining in the account may be withdrawn for the Designated Beneficiary. The Designated Beneficiary will be subject to both income tax and the additional 10 percent tax on the portion of the amount withdrawn that represents earnings if the Designated Beneficiary does not have any qualified education expenses in the same taxable year he/she makes the withdrawal. Alternatively, if the amount in the Designated Beneficiary's Coverdell ESA is withdrawn and rolled over (as described in Q&A19 of this section) to another Coverdell ESA for the benefit of a member of the Designated Beneficiary's family, the amount rolled over will not be taxable.

### **Q21: Rather than rolling over money from one Coverdell ESA to another, may the Designated Beneficiary of the account be changed from one child to another without triggering a tax?**

A21: No, not under the Credit Union Coverdell ESA Custodial Agreement.

### **Q22: May a student or the student's parents claim the Hope Scholarship Credit or Lifetime Learning Credit for the student's expenses in a taxable year in which the student receives money from a Coverdell ESA on a tax-free basis?**

A22: Yes, but expenses used to claim the Hope Scholarship Credit and Lifetime Learning Credit may not also be used to take a tax-free withdrawal from a Coverdell ESA.

### **Q23: May contributions be made to both a qualified tuition program and a Coverdell ESA on behalf of the same Designated Beneficiary in the same taxable year?**

A23: Yes.