

Summary of Education Savings Accounts (ESA)/Education IRA

Feature

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| 1. Maximum Non-deductable Contribution | 1. \$2,000 per year per child of all contributions combined. Contributions are not tax deductible. |
| 2. Adjusted Gross Income Phase Out Range | 2. Single = \$95,000 - \$110,000
Married Filing jointly = \$190,000 - \$220,000 |
| 3. Qualified Educational Institution | 3. Include qualified elementary, secondary schools, private, public and religious schools, special need education. |
| 4. Qualified Expenses | 4. Include tuition, room and board, fees, books, supplies, computer and related technology equipment required for the beneficiary. |
| 5. Age Consideration | 5. Can contribute under age 18 of beneficiary, distribute or rollover to another ESA before age 30 of beneficiary.
Account may be contributed to after age 18 and continue after age 30 for special need education only. |
| 6. Time for making contributions | 6. Before April 15 following the tax year. |
| 7. Time for making corrective withdrawals | 7. Excess contribution is subject to 6% penalty; excess withdrawal is subject to 10% penalty. |
| 8. What if the beneficiary doesn't attend college? | 8. The authorized person can change the beneficiary to another eligible family member. He/she can also withdraw the fund and pay 10% penalty, in addition to income tax, on earnings portion of the withdrawal. |
| 9. Tax Reporting | 9a. Similar to an IRA, the annual contribution is reported to the IRS by using Form 5498-ESA and annual statements to the authorized person.
b. The custodian is to report any withdrawal with Form 1099-Q. The beneficiary is responsible for any income tax to the IRS as part of his income tax return. |

This Disclosure is modified according to IRS Notice 97-60 and revised according to EGTRRA

EDUCATION IRA's

Beginning January 1, 2001, taxpayers may deposit up to \$2,000 per year into an Education IRA for a child under age 18. Parents, grandparents, other family members, friends, and a child him/herself may contribute to the child's Education IRA, 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-free until distributed, and the child will not owe tax on any withdrawal from the account if the child's qualified higher education expense at an eligible educational institution for the year equal or exceed the amount of the withdrawal. If the child does not need the money for postsecondary education, the account balance can be rolled over to the Education IRA of certain family members who can use it for their higher education. Amounts withdrawn from an Education IRA that exceeds the child's qualified higher education expenses in a taxable year are generally subject to income tax and to an additional tax of 10 percent. The Hope Scholarship Credit and Lifetime Learning Credit may not be claimed for a student's expenses in a taxable year in which the student takes a tax-free withdrawal from an Educational IRA.

Q1: What is an Education IRA?

A1: An Education IRA is a trust or custodial account that is created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of the designated beneficiary of the account. The account must be designated as an Education IRA when it is created in order to be treated as an Education IRA for tax purposes.

Q2: For whom may an Education IRA be established?

A2: An Education IRA may be established for the benefit of anyone under age 18. Contributions to the Education IRA will not be accepted after the designated beneficiary reaches his/her 18th birthday, except when the designated beneficiary has a need for a necessary special education, then contributions may be made beyond 18.

Q3: Where may an individual open an Education IRA?

A3: An individual may open an Education IRA with any bank, or other entity that has been approved to service as a nonbank trustee or custodian of an individual retirement account (IRA), and the bank or entity is offering Education IRA's. Other entities that wish to offer Education IRA's but are not approved to service as IRA trustees or custodians may seek approval by following the same IRS procedures used for approval of other IRA nonbank trustees. See Notice 97-57, 1997-43 I.R.B. (October 27, 1997).

Q4: When may a taxpayer start contributing to an education IRA for a child?

A4: A taxpayer may start making contributions on January 1, 1998, or anytime thereafter.

Q5: How much may be contributed to a child's education IRA?

A5: Up to \$2,000 per year in aggregate contributions may be made for the benefit of any child. The contributions beginning on and after January 1, 2002 may be placed in a single Education IRA or into multiple Education IRA's.

Q6: What happens if more than \$2,000 is contributed to an Education IRA 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) before June 1, the excess contributions are subject to a 6 percent excise tax for each year the excess amount remains in the account.

Q7: May contributions other than cash be made to a child's Education IRA?

A7: No. Education IRA's are permitted to accept contributions made in cash only.

Q8: May contributors take a deduction for contributions made to an Education IRA?

A8: No.

Q9: Are there any restrictions on who can contribute to an Education IRA?

A9: Any individual may contribute up to \$2,000 to a child's Education IRA if the individual's modified adjusted gross income for the taxable year is no more than \$95,000 adjusted (\$190,000 adjusted for married taxpayers filing jointly). (See Sec. 1, Q&A6 for a description of modified adjusted gross income.) 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 Education IRA.

Q10: May a child contribute to his/her own Education IRA?

A10: Yes

Q11: Does a taxpayer have to be related to the designated beneficiary in order to contribute to the designated beneficiary's Education IRA?

A11: No

Q12: How many Education IRAs may a child have?

A12: There is no limit on the number of Education IRAs that may be established designating a particular child 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 an Education IRA to pay qualified higher 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 higher education expenses.

Q14: What happens when a designated beneficiary withdraws assets from an Education IRA to pay for qualified education?

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” include (1) qualified elementary and secondary education expenses (as described in (1) below), and (2) qualified higher education expenses as described in (2) below). Qualified education expenses also include any contribution to a qualified tuition program (529 Plan) on behalf of the beneficiary.

(1) Qualified elementary and secondary education expenses.

Qualified elementary and secondary education expenses are expenses for tuition, fees, academic tutoring, special needs services in the case of a special needs beneficiary, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary as an elementary or secondary school student at a public, private, or religious school. (“School” means any school that provides elementary or secondary education [kindergarten through grade 12] as determined under state law.) Qualified elementary and secondary education expenses also include expenses for room and board, uniforms, transportation and supplementary items and services (including extended day programs) that are required or provided by a public, private, or religious school in connection with enrollment or attendance. Expenses for the purchase of any computer technology or equipment, or to pay for internet access and related services, are considered qualified education expenses if such technology, equipment, or services are to be used by the beneficiary and the beneficiary’s family during any of the years the beneficiary is in school. Such expenses do not include the cost of computer software designed for sports, games, or hobbies unless the software is predominantly educational in nature.

(2) Qualified higher education expenses.

Qualified higher education expenses are expenses for tuition, fees, special needs services in the case of a special needs student, books, supplies and equipment required for the enrollment or attendance of the beneficiary at an eligible educational institution. Qualified higher education expenses also include reasonable room and board costs if the beneficiary is at least a half-time student at an eligible educational institution. Room and board costs are generally limited to the allowance for room and board included in the cost of attendance as determined by the institution. For students living in housing owned and operated by the eligible educational institution, the actual invoice amount the beneficiary is charged by the eligible educational institution for room and board will be includible as qualified education expenses if that amount is greater than the allowance described above. A beneficiary will be considered to be enrolled at least half-time if the beneficiary is enrolled for at least the full-time academic workload for the course of study the beneficiary is pursuing as determined under the standards of the institution where the beneficiary 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 of 1965.

Q16: What is an eligible educational institution for purposes of qualified higher education expenses?

A16: An eligible educational institution is any college, university, vocational school, or other post secondary educational institution described in section 481 of the Higher Education Act of 1965 and which is 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 higher education expenses.) The educational institution should be able to tell you if it is an eligible educational institution.

Q17: What happens if a designated beneficiary withdraws an amount from an Education IRA but does not have any qualified higher education expenses to pay in the taxable year he/she makes the withdrawal?

A17: Generally, if a designated beneficiary withdraws an amount from an Education IRA and does not have any qualified higher 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-free in the account. The taxable portion of the distribution is also subject to a 10 percent additional tax unless an exception applies.

Q18: Is a distribution from an Education IRA taxable if the distribution is contributed to another Education IRA?

A18: Any amount distributed from an Education IRA and rolled over to another Education IRA 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 Education IRA 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 Education IRAs does not apply to these rollover contributions. For example, an older brother who has \$2,000 left in his Education IRA after he graduates from college can roll over the full \$2,000 balance to an Education IRA for his younger sister who is still in high school without paying any tax on the transfer.

Q19: What happens to the assets remaining in an Education IRA after the designated beneficiary finishes his/her education?

A19: 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 higher education expenses in the same taxable year he/she makes the withdrawal. Alternatively, if the amount in the designated beneficiary's Education IRA is withdrawn and rolled over (as described in Q&A 18 of this section) to another Education IRA for the benefit of a member of the designated beneficiary's family, the amount rolled over will not be taxable.

Q20: Rather than rolling over money from one Education IRA to another, may the designated beneficiary of the account be changed from one child to another without triggering a tax?

A20: Yes, provided: (1) the terms of the particular trust or custodial account permit a change in designated beneficiaries (each trustee or custodian will control whether options like this one are available in the accounts they offer), and (2) the new designated beneficiary is a member of the previous designated beneficiary's family. (See Q&A 18 in this section).

Q21: May a beneficiary or his or her parents claim the Hope Scholarship Credit or Lifetime Learning Credit for the beneficiary's expenses in a taxable year in which the beneficiary received money from an education savings account on a tax-free basis?

A21: Yes. For more information about the Hope Scholarship Credit and the Lifetime Learning Credit, see IRS Publication 970, Tax Benefits for Education.

Q22: May contributions be made to both a qualified state tuition program and an Education IRA on behalf of the same designated beneficiary in the same taxable year?

A22: Yes. Contributions can be made to a qualified tuition program (QTP) and ESA in the same year for the same beneficiary.

Please check with your CPA or attorney for more detailed explanation if you need to.