

CPA Continuing Education
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Coverdell Education Savings Accounts

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Definition

A Coverdell education savings account (formerly known as an education IRA) is a tax-advantaged educational savings account that you can establish for any child under the age of 18 (this age limit does not apply to beneficiaries with special needs).

Contributions to a Coverdell ESA can total up to \$2,000 each year. Contributions are made with after-tax dollars, but distributions used to pay qualified education expenses are income tax free at the federal level. States may also exempt such distributions from state income tax.

Note: The provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 that increased the annual contribution limit for Coverdell ESAs to \$2,000 will expire on December 31, 2010. Unless Congress acts, after this date, the annual contribution limit for Coverdell ESAs will revert to \$500, the limit that was in effect prior to January 1, 2002.

Prerequisites

- Your modified adjusted gross income for the year is less than \$110,000 or \$220,000 if married filing jointly
- Other individuals have not already contributed the maximum annual amount to a Coverdell ESA for the benefit of the same beneficiary
- The beneficiary is under age 18 (this age limit does not apply to beneficiaries with special needs)

Key Strengths

- Qualifying distributions (including any earnings) are not included in income at the federal level, and possibly the state level
- Funds in a Coverdell ESA can be rolled over without penalty into another Coverdell ESA for the benefit of a qualifying family member
- The beneficiary can take tax-free distributions from a Coverdell ESA in the same year that a parent or other individual claims the Hope credit (renamed the American Opportunity tax credit for 2009 and 2010) or Lifetime Learning credit for education expenses paid on behalf of same beneficiary, as long as the distribution and credit don't cover the same expenses
- Qualified education expenses include expenses incurred at elementary and secondary schools (K-12), including public, private, and religious schools

Key Tradeoffs

- Your ability to contribute is limited if your modified adjusted gross income is between \$95,000 and \$110,000 or between \$190,000 and \$220,000 if married filing jointly
- After-tax dollars are contributed
- Distributions of earnings not used for education expenses are subject to tax and penalty
- Funds must be distributed within 30 days of the designated beneficiary reaching age 30 (this age limit does not apply to beneficiaries with special needs)

Variations from State to State

- None

How Is It Implemented?

- Establish a Coverdell ESA with a bank or other financial institution approved by the IRS
- Depending on the institution, there may be fees associated with opening and/or maintaining a Coverdell ESA
- Contributions can be made up until April 15 of the year following the tax year for which the contribution is being made

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Janney Montgomery Scott LLC Financial Consultants are available to discuss the suitability and risks involved with various products and strategies presented. We will be happy to provide a prospectus, when available, and other information upon request.

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