

The old educational individual retirement account has received a name change and has undergone some significant modifications.

Now known as the Coverdell education savings account, the contribution limit has been raised as has the income limitations for those wishing to make a contribution to an account.

Contributions under the old plan were limited to \$500 per beneficiary. With the Coverdell plan, that limit has been raised to \$2,000 per designated beneficiary per year beginning in 2002. The \$2,000 contribution is not deductible but distributions, within the limits, are not taxed.

Amounts distributed from a Coverdell education savings account are excludible from the gross income of the distributee to the extent that the amounts distributed do not exceed the qualified education expenses of the distributee during the year the distribution was made. Distributions in excess of such expenses are includible in the gross income of the distributee.

The annual contribution limit for a Coverdell education savings account is phased out for individual contributors with modified adjusted gross income (AGI) between \$95,000 and \$110,000 (\$190,000 and \$220,000 for joint returns). Individuals with modified AGI above the phase-out range may not make contributions to a Coverdell education savings account established on behalf of any other individual. Prior to amendment, the phase-out range for married individuals filing jointly was \$150,000 and \$160,000.

Coverdell education savings accounts must be created exclusively for the purpose of paying "qualified education expenses." For taxable years beginning before 2002, qualified education expenses were limited to qualified higher education expenses, i.e., tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution. Beginning after 2001, qualified higher education expenses also include elementary or secondary school expenses. Such expenses are:

- tuition, fees, academic tutoring, special need services, books, supplies, and other equipment in connection with the enrollment or attendance of the beneficiary as an elementary or secondary school student at a public, private, or religious school;
- computer technology or equipment or Internet access and related services, if these are to be used by the beneficiary or the beneficiary's family during any of the years that the beneficiary is in school.
- room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by a school in connection with enrollment or attendance of the beneficiary.

Qualified higher education expenses are reduced by scholarship or fellowship grants, certain educational assistance allowances, and educational expenses that are excludible from gross income. Qualified higher education expenses are also reduced by the amount of such expenses that were taken

into account in determining the Hope or Lifetime Learning credit allowed.

For federal estate and gift tax purposes, any contribution to a Coverdell education savings account will be treated as a gift, but any contributions are eligible for the annual gift tax exclusion.

An additional 10% tax applies to the distributee for distributions from a Coverdell education savings account not used for educational expenses unless the distribution is made on or after the death of the designated beneficiary or due to the designated beneficiary's being disabled.

The law permits tax-free (and penalty-free) rollovers from a Coverdell education savings account to the extent that it is paid into another Coverdell education savings account of the same beneficiary or a family member of the beneficiary within 60 days of the distribution if the beneficiary's family member has not reached age 30. A rollover may occur only once during a 12-month period. The age limitation does not apply to any designated beneficiary with special needs.

After the death or divorce of a Coverdell education savings account beneficiary, the balance in the Coverdell education savings account can be transferred tax-free to a member of the beneficiary's family. For this purpose the family member does not have to be under age 30.

Contributions in excess of \$2,000 are subject to a 6% tax on the excess, unless the contributions are returned before the due date of the contributor's return. Rollover contributions are also not treated as excess contributions for purposes of the tax.

Any balance remaining in a Coverdell education savings account on the date a beneficiary becomes 30 years old must be distributed within 30 days of the date, and the earnings portion of such a distribution will be includible in the gross income of the beneficiary and subject to an additional 10% penalty tax because the distribution was not for educational purposes.

A taxpayer may claim a Hope credit or Lifetime Learning credit for a taxable year and exclude from gross income amounts distributed from a Coverdell education savings account on behalf of the same student. However, the distribution may not be used for the same educational expenses for which a credit was claimed.

A Coverdell education savings account is a trust. There must be a written governing instrument creating the trust. In addition, the trust assets may not be invested in life insurance contracts, nor may the assets of the trust be commingled with other property except in a common trust fund or common investment fund. Contributions to the Coverdell education savings account only may be made in cash and may not be made after the designated beneficiary attains age 18.