

Coverdell Education Savings Accounts

Those who want more investment choices may want to consider Coverdell Education Saving Accounts (ESAs).

No Investment Restrictions

Formerly known as Education IRAs, ESAs are another tax-advantaged way to pay for college. Unlike 529 plans, your investment options are virtually limitless. Except for investing in life insurance contracts, you can buy and sell what you want whenever you want. Also, you can set them up at almost any brokerage firm, mutual-fund company, or other financial institution.

Federal Tax Advantages

As with 529 plans, contributions are not deductible, but earnings in ESAs are tax-deferred, and withdrawals that are used for qualified education expenses are tax-free.

Education Expenses Covered

One advantage that ESAs have over other tax-advantaged saving options is that you can make tax-free withdrawals to pay for private elementary and high school expenses, as well as post-secondary school expenses. So if a private school is in the future, one option you might want to consider is saving for that expense in an ESA and using a 529 plan for college.

Contribution Limits

ESAs have two annual contribution limits for individuals:

1. You can give up to \$2,000 to any one beneficiary assuming you meet the ESA income limits discussed below.
2. The total of all contributions to all ESAs set up for one beneficiary cannot exceed \$2,000. If other family members set up ESAs for your child, you need to check with them to make sure this contribution limit is not exceeded.

If you exceed these contribution limits, there is a 6% excise tax each year on excess contributions.

Income Restrictions

A couple filing a joint return can contribute \$2,000 if their modified adjusted gross income is less than \$190,000 a year. The ability to contribute is phased out for couples filing jointly with modified adjusted gross incomes of between \$190,000 and \$220,000. Contributions are not allowed for couples filing jointly whose modified adjusted gross income is \$220,000 or above.

Single taxpayers will be able to contribute \$2,000 if their modified adjusted gross income is less than \$95,000. Single taxpayers' ability to contribute is phased out if their modified adjusted gross income is between \$95,000 and \$110,000. No contributions are allowed if their modified adjusted gross income is \$110,000 or above.

Organizations, such as corporations, can also contribute to ESAs and are not subject to any income limits.

Figuring Your ESA Contribution Limit. If your income is between \$190,000 and \$220,000 (joint filers), or \$95,000 and \$110,000 (single filers), you can figure your ESA contribution limit by using the following equations:

Married Joint Filers

$$\frac{\$2,000 - (\text{Modified Adjusted Gross Income} - \$190,000 * \$2,000)}{\$30,000} = \text{Contribution Limit}$$

Single Filers

$$\frac{\$2,000 - (\text{Modified Adjusted Gross Income} - \$95,000 * \$2,000)}{\$15,000} = \text{Contribution Limit}$$

Fees, Charges and Expenses

Fees, charges and expenses will vary depending on the investments you choose and the institution with which you open an ESA. Remember, however, that because of the fairly low contribution limits, even small annual fees or expenses could make a big difference in the value of your investment over time.