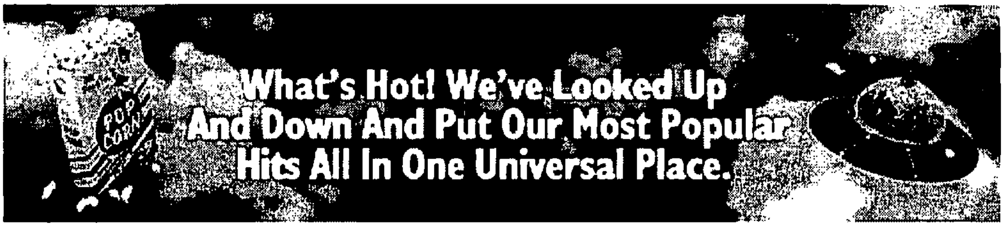

Notice 97-60

Education IRAs

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Beginning January 1, 1998, taxpayers may deposit up to $500 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 $500 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 expenses 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 Amounts withdrawn from an Education IRA that exceed the child's qualified higher education expenses in a taxable year are generally subject to income tax and to an additional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 Education IRA.

Questions and Answers:

Q&ampA, from Column 1 -

For whom may an Education IRA be established?
- Where may an individual open an Education IRA?
- When may a taxpayer start contributing to an Education IRA for a child?
- How much may be contributed to a child's Education IRA?
- What happens if more than $500 is contributed to an Education IRA on behalf of a child in a calendar year?
- May contributions other than cash be made to a child's Education IRA?
- May contributors take a deduction for contributions made to an Education IRA?
- Are there any restrictions on who can contribute to an Education IRA?

See *Q&ampA*, Column 2

What happens to the assets remaining in an Education IRA after the designated beneficiary finishes his/her postsecondary education?
- 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?
- 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 an Education IRA on a tax-free basis?
- 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?

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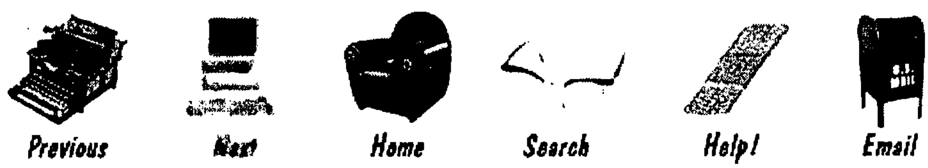

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Education IRAs Questions and Answers

Q.1. What is an Education IRA?

A.1. 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.

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Education IRAs Questions and Answers

Q.2. For whom may an Education IRA be established?

A.2. An Education IRA may be established for the benefit of any child under age 18. Contributions to the Education IRA will not be accepted after the designated beneficiary reaches his/her 18th birthday.

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Education IRAs Questions and Answers

Q.3. Where may an individual open an Education IRA?

A.3. An individual may open an Education IRA 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 Education IRAs. Other entities that wish to offer Education IRAs but are not approved to serve 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).

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Education IRAs Questions and Answers

Q.4. When may a taxpayer start contributing to an Education IRA for a child?

A.4. A taxpayer may start making contributions on January 1, 1998, or at any time thereafter.

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Education IRAs Questions and Answers

Q.5. How much may be contributed to a child's Education IRA?

A.5. Up to $500 per year in aggregate contributions may be made for the benefit of any child. The contributions may be placed in a single Education IRA or in multiple Education IRAs.

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Education IRAs Questions and Answers

Q.6. What happens if more than $500 is contributed to an Education IRA on behalf of a child in a calendar year?

A.6. Aggregate contributions for the benefit of a particular child in excess of $500 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 the tax return for the year is due, the excess contributions are subject to a 6 percent excise tax for each year the excess amount remains in the account.

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Education IRAs Questions and Answers

Q.7. May contributions other than cash be made to a child's Education IRA?

A.7. No. Education IRAs are permitted to accept contributions made in cash only.

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Education IRAs Questions and Answers

Q.8. May contributors take a deduction for contributions made to an Education IRA?

A.8. No.

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Education IRAs Questions and Answers

Q.9. Are there any restrictions on who can contribute to an Education IRA?

A.9. Any individual may contribute up to $500 to a child's Education IRA if the individual's modified adjusted gross income for the taxable year is no more than $95,000 ($150,000 for married taxpayers filing jointly). (See Sec. 1, Q&A6 for a description of modified adjusted gross income.) The $500 maximum contribution per child is gradually reduced for individuals with modified adjusted gross income between $95,000 and $110,000 (between $150,000 and $160,000 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 $450 for that year. Taxpayers with modified adjusted gross income above $110,000 ($160,000 for married taxpayers filing jointly) cannot make contributions to anyone's Education IRA.

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Education IRAs Questions and Answers

Q.10. May a child contribute to his/her own Education IRA?

A.10. Yes.

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Education IRAs Questions and Answers

Q.11. Does a taxpayer have to be related to the designated beneficiary in order to contribute to the designated beneficiary's Education IRA?

A.11. No.

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Education IRAs Questions and Answers

Q.12. How many Education IRAs may a child have?

A.12. There is no limit on the number of Education IRAs 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 $500.

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Education IRAs Questions and Answers

Q.13. 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?

A.13. 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.

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Education IRAs Questions and Answers

Q.14. What happens when a designated beneficiary withdraws assets from an Education IRA to pay for college?

A.14. 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 higher education expenses.

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Education IRAs Questions and Answers

Q.15. What are "qualified higher education expenses"?

A.15. "Qualified higher education expenses" mean expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible 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 the designated beneficiary is at least a half-time student at an eligible educational institution. The standards for determining whether a student is enrolled at least half-time are the same as those used for the Hope Scholarship Credit. (See Sec. 1, Q&A3.)

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Education IRAs Questions and Answers

Q.16. What is an eligible educational institution?

A.16. 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 higher education expenses.) (See Sec. 1, Q&A4; Sec. 2, Q&A3; and Sec. 4, Q&A2.)

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Education IRAs Questions and Answers

Q.17. 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?

A.17. 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.

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Education IRAs Questions and Answers

Q.18. Is a distribution from an Education IRA taxable if the distribution is contributed to another Education IRA?

A.18. 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 $500 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.

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Education IRAs Questions and Answers

Q.19. What happens to the assets remaining in an Education IRA after the designated beneficiary finishes his/her postsecondary education?

A.19. 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&A18 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.

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Education IRAs Questions and Answers

Q.20. 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?

A.20. 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&A18 in this section).

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Education IRAs Questions and Answers

Q.21. 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 an Education IRA on a tax-free basis?

A.21. No. If a student is receiving a tax-free distribution from an Education IRA in a particular taxable year, none of that student's expenses may be claimed as the basis for a Hope Scholarship Credit or Lifetime Learning Credit for that year. However, the student may waive the tax-free treatment of the Education IRA distribution and elect to pay any tax that would otherwise be owed on an Education IRA distribution so that the student or the student's parents may claim a Hope Scholarship Credit or Lifetime Learning Credit for expenses paid in the same year the Education IRA distributions are received.

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Education IRAs Questions and Answers

Q.22. 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?

A.22. No. Any amount contributed to an Education IRA on behalf of a designated beneficiary during any taxable year in which an amount is also contributed to a qualified state tuition program on behalf of the same beneficiary will be treated as an excess contribution to the Education IRA. (See Q&A6 in this section for the treatment of excess contributions.)

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The Educational IRA

One of the many educational benefits of the 1997 Taxpayer's Relief Act is the Eucational IRA. While the EIRA has nothing to do with saving for retirement, it has everything to do with saving for college and operates in muh the same way as a traditional IRA.

Beginning January 1, 1998, taxpayers may deposit up to $500 per year into an EIRA for a child under 18. Anyone may contribute to the EIRA, as long as total annual contributions do not exceed $500. If more than $500 is contributed, the excess contributions (if not withdrawn) are subject to an annual 6% excise tax. Contributions to an EIRA are not tax-deductible. The money in an EIRA grows tax-free until distribution. There is no limit to number of EIRAs a child may have, as long as total combined contributions to all the accounts does not exceed $500 per year. The funds in an EIRA must be used to pay tuition and fees. If funds are withdrawn when the student does not have these expenses, then the accumulated earnings of that distribution are taxable.

After the beneficiary completes college, any remaining amount in an EIRA may either be withdrawn, and thereby subject to both income tax and a 10% tax on earnings, or may be rolled over to another EIRA. Any amount distributed from an EIRA and rolled over to another EIRA is not taxable, and the $500 contribution limit does not apply to rollover contributions.

Distributions from an EIRA may not be used in conjunction with the Hope Scholarship or Lifetime Learning Credit

Another excellent option for helping save for college is pre-paid tuition. These programs are offered by several states. To learn more, click here.

Page last updated March 8, 1999.

Problems? Contact the webmaster.
Good luck finding Financial Aid!

State Prepaid Tuition Programs and College Savings Plans

A prepaid tuition plan is a college savings plan that will rise in value at the same rate as college tuition. Parental savings plans are different from prepaid tuition plans in that there is no guarantee that the amount saved will equal the amount of tuition in the future; however there are tax advantages to these savings plans. Savings plans permit the participant to use the savings at a variety of institutions, but a prepaid tuition plan may be limited by the plan's institutions. Many savings plans include the ability to save for other college expenses whereas prepaid tuition plans are often limited to tuition and fees. Following are some of the pre-paid tuition plans offered around the country.

If you know of another prepaid tuition program or college savings plan or have other questions, please send a message to Mapping Your Future.

Alabama Prepaid Affordable College Tuition (PACT) (Alabama)
http://www.asc.edu/archives/agencies/prepaid.html

Alaska Advance College Tuition (ACT) (Alaska)
For more information call 1-800-478-0003 or 1-907-474-7469.

Arizona Students' Association (Arizona)
http://www.asa.asu.edu/prepa.html

The Goldern State Scholarshare Program (California)
http://www.csac.ca.gov/scholar/scholar.htm

Colorado Prepaid Tuition Fund (Colorado)
http://www.prepaidtuition.org

Connecticut Higher Education Trust (CHET) (Connecticut)
For more information, call 1-860-566-2982.

College Investment Plan (Delaware)
http://personal311.fidelity.com:80/planning/college/content/delinvest.html.tvsr

Florida Prepaid College Tuition Program (Florida)
http://fsba.state.fl.us/prepaid

Georgia HOPE Scholarship Program (Georgia)
http://www.hope.gsfc.org

Illinois Prepaid Tuition Program (Illinois)
http://www.collegeillinois.com

Indiana Family College Savings Plan (Indiana)
http://www.che.state.in.us/ifcsp

College Savings (Iowa)
http://www.treasurer.state.ia.us

Kentucky (Kentucky)
Call 1-800-928-8926 or 1-800-338-0318 for more information.

Louisiana START Saving Program (Louisiana)
http://www.osfa.state.la.us/START.htm

Maryland Prepaid College Trust (Maryland)
http://www.prepaid.usmd.edu

Massachusetts College Saving Program, The U. Plan (Massachusetts) http://www.mefa.org

Michigan Education Trust (MET) (Michigan)
For more information call 1-800-MET-4KID or write to Michigan Education Trust, PO Box 30198, Lansing, MI 48909.

Mississippi Prepaid Affordable College Tuition Program (MPACT) (Mississippi)
http://www.treasury.state.ms.us/mpact.htm

Montana Family Education Savings Program (Montana)
http://montana.collegesavings.com

Nevada State Prepaid Tuition Program (Nevada)
For more information, call 1-702-687-5200.

Unique College Investing Plan (New Hampshire)
http://www.state.nh.us/treasury

New Jersey Better Education Savings Trust (New Jersey)
http://www.state.nj.us/treasury/osa/njbes

New York College Choice Tuition Savings Program (New York)
http://www.nysaves.org/

North Carolina College Vision Fund (North Carolina)
http://www.collegevisionfund.org/

Ohio Tuition Trust Authority (OTTA) (Ohio)
http://www.prepaid-tuition.state.oh.us

Pennsylvania Tuition Account Program (TAP) (Pennsylvania)
http://www.patap.org

Rhode Island Higher Education Savings Trust
http://www.rihest.com

South Carolina Tuition Prepayment Program
www.state.sc.us/tpp

Tennessee BEST (Tennessee)
http://www.state.tn.us/treasury/best.htm

Texas Tomorrow Fund -- Prepaid College Tuition Program (Texas)
http://www.window.state.tx.us/comptrol/ttf/ttfmain.html

Utah Educational Savings Plan Trust (Utah)
For more information, call 1-800-418-2551.

Vermont Higher Education Savings Plan
http://www.vpep.state.va.us

Washington Guaranteed Education Tuition (GET) (Washington)
http://www.get.wa.gov

West Virginia Prepaid College Plan
http:www.wvtreasury.com/prepaid.htm

Wisconsin Education Investment Program (EdVest WI) (Wisconsin)
For more information, call 1-888-EDVESTWI (1-888-338-3789)

Wyoming Advance Payment of Higher Education Costs (Wyoming)
For more information call 1-307-766-3214.