

Coverdell Education Savings Account (ESA)

ESA Basics – The Advantages and Disadvantages

A Coverdell Education Savings Account (ESA) helps parents and students save for elementary, secondary and college education expenses. Annual contributions are limited to \$2,000. Earnings grow tax-free and qualified distributions are tax free and penalty free.

Education Planning

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Advantages of Coverdell ESAs

- Contributions grow tax-free and can be made up until April 15 of the following year.
- Qualified withdrawals are federal income tax-free – As long as the proceeds are used to pay for qualified education expenses including tuition, fees, books, supplies, room and board. Also included are transportation, computers, and other technology, such as internet access as long as such equipment is to be used during any of the years the designated beneficiary is in school.
- Funds can be used for K-12 as well as post-secondary education expenses.
- Investment option flexibility – Coverdell ESAs offer the same types of investments found in individual retirement accounts. Coverdell ESAs can be rolled into 529s.
- Considered an asset of the parent – If the parent or student is the custodian of the account, the ESA will be assessed at the parental rate of 5.6% for federal financial aid purposes.
- Ability to change beneficiary – If one child does not use the ESA, it can be transferred to another child who is considered a family member under the age of 30.

Disadvantages of Coverdell ESAs

- Low contribution limit of \$2,000 – The maximum annual aggregate contribution to all accounts for one child is \$2,000, contributions over this amount are subject to an excise tax.
- Income restrictions – Not available to high-income families (\$220,000 joint MAGI, \$110,000 single MAGI).
- Age limitations – Coverdell accounts can only be set up for individuals under the age of 18 and if funds are not used by the time the beneficiary reaches age 30, the funds must be distributed or changed to a new beneficiary who is a family member and under the age of 30. The earnings will be taxed at the beneficiary's tax rate plus a 10% penalty.
- Cannot take money back – Your contributions go into an account that will eventually go to your child (or beneficiary changed to a family member) if not used for college. You cannot refund the account back to yourself which means you lose some degree of control.
- No state tax deduction – Coverdell ESAs do not offer any state tax benefits.
- Coordination with other education tax incentives can be tricky – You cannot use a tax-free distribution from a Coverdell for the same education expense that is used for the Hope or Lifetime Learning credit.
- Annual Account Fee – Baird charges a \$25 annual account fee which could significantly affect your overall investment return.

ESA Basics – The Advantages and Disadvantages, *continued*

Coverdell ESA and 529 Comparisons

Feature	Coverdell Education Savings Account (ESA)	529 College Savings Plan
Contribution Eligibility Income Limits	Contributor income limits (MAGI ¹): Single Filer: \$95,000 or less: Full Contribution \$95,001 – \$110,000: Partial Contribution \$110,001 or more: No Contribution Joint Filers: \$190,000 or less: Full Contribution \$190,001 – \$220,000: Partial Contribution \$220,001 or more: No Contribution	No income limitations
Contribution Limits	\$2,000 per year	Program specific, but most are over \$500,000
Control of Assets	The responsible individual (RI) must be the parent or legal guardian of the beneficiary but may name the designated beneficiary as successor RI upon the designated beneficiary's attainment of age of majority under state law or any later date before the designated beneficiary's attainment of age 30	The owner of a 529 account can be any legal U.S. citizen aged 18 or older. The owner does not have to be related to the beneficiary.
Ability to change the Beneficiary	Yes. The new beneficiary must be a relative of the current beneficiary and under the age of 30.	Yes. The new beneficiary must be a relative of the current beneficiary. There are no age restrictions.
Self-Directed Investment	Yes	No
Requirement to Deplete Account	Account must be depleted or transferred to a new beneficiary by age 30	No time limit or age restrictions
Qualified Distribution	Elementary, Secondary and Higher education expenses including tuition, fees, books, computers, transportation, supplies & equipment, and room & board	K-12 tuition up to \$10,000. Higher education expenses including tuition, room & board, fees, books, computers, supplies & equipment. Student loan debt up to \$10,000. Fees, books & supplies required for an apprenticeship program. 529 to Roth rollovers. <i>(Check for restrictions and with your state for any state tax implications)</i>
Taxation of Withdrawals	Federally tax-free and penalty-free if the money is used for qualified education expenses. Earnings portion of non-qualified distributions will be subject to taxes and a 10% penalty ² .	Federally tax-free and penalty-free if the money is used for qualified education expenses. Earnings portion of non-qualified distributions will be subject to taxes and a 10% penalty ² .
Effect on Federal Financial Aid	LESS. Considered the asset of the account RI/custodian	LESS. The account is the asset of the owner
Compatible with other Savings Vehicles	Contributions may be made to both a Coverdell ESA and a qualified tuition program (529 plan) during the same year	Contributions may be made to both a Coverdell ESA and a qualified tuition program (529 plan) during the same year

¹ Modified Adjusted Gross Income (MAGI) – will be the same as Adjusted Gross Income for most taxpayers. See your tax advisor for complete details.

² The earnings portion of any withdrawal not used for qualified education expenses (or not made on account of death, disability or receipt of college scholarship of the beneficiary) is subject to a 10% penalty and the earnings portion will be treated as ordinary income and taxable to the recipient.

Investors should consider the investment objectives, risks, charges and expenses associated with a 529 Plan before investing. This and other information is available in a Plan's official statement. The official statement should be read carefully before investing.

Depending on your state of residence, there may be an in-state plan that provides tax and other benefits such as financial aid, scholarships and creditor protection that are not available through an out-of-state plan. Robert W. Baird & Co. does not provide tax advice. Before investing in any state's 529 plan, you should consult your tax advisor.