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Internal Revenue Code Section 530(d)(4)

Coverdell education savings accounts

(a) General rule.

A Coverdell education savings account shall be exempt from taxation under this subtitle. Notwithstanding the preceding sentence, the Coverdell education savings account shall be subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable organizations).

(b) Definitions and special rules.

For purposes of this section -

(1) Coverdell education savings account.

The term "Coverdell education savings account" means a trust created or organized in the United States exclusively for the purpose of paying the qualified education expenses of an individual who is the designated beneficiary of the trust (and designated as a Coverdell education savings account at the time created or organized), but only if the written governing instrument creating the trust meets the following requirements:

(A) No contribution will be accepted-

(i) unless it is in cash,

(ii) after the date on which such beneficiary attains age 18, or

(iii) except in the case of rollover contributions, if such contribution would result in aggregate contributions for the taxable year exceeding \$2,000.

(B) The trustee is a bank (as defined in section 408(n)) or another person who demonstrates to the satisfaction of the Secretary that the manner in which that person will administer the trust will be consistent with the requirements of this section or who has so demonstrated with respect to any individual retirement plan.

(C) No part of the trust assets will be invested in life insurance contracts.

(D) The assets of the trust shall not be commingled with other property except in a common trust fund or common investment fund.

(E) Except as provided in subsection (d)(7) , any balance to the credit of the designated beneficiary on the date on which the beneficiary attains age 30 shall be distributed within 30 days after such date to the beneficiary or, if the beneficiary dies before attaining age 30, shall be distributed within 30 days after the date of death of such beneficiary.

The age limitations in subparagraphs (A)(ii) and (E), and paragraphs (5) and (6) of subsection (d), shall not apply to any designated beneficiary with special needs (as determined under regulations prescribed by the Secretary).

(2) Qualified education expenses.

(A) In general. The term "qualified education expenses" means-

(i) qualified higher education expenses (as defined in section 529(e)(3)),
and

(ii) qualified elementary and secondary education expenses (as defined in paragraph (3)).

(B) Qualified tuition programs. Such term shall include any contribution to a qualified tuition program (as defined in section 529(b)) on behalf of the designated beneficiary (as defined in section 529(e)(1)); but there shall be no increase in the investment in the contract for purposes of applying section 72 by reason of any portion of such contribution which is not includible in gross income by reason of subsection (d)(2) .

(3) Qualified elementary and secondary education expenses.

(A) In general. The term "qualified elementary and secondary education expenses" means-

(i) expenses for tuition, fees, academic tutoring, special needs services in the case of a special needs beneficiary, books, supplies, and other equipment which are incurred in connection with the enrollment or attendance of the designated beneficiary of the trust as an elementary or secondary school student at a public, private, or religious school,

(ii) expenses for room and board, uniforms, transportation, and supplementary items and services (including extended day programs) which are required or provided by a public, private, or religious school in connection with such enrollment or attendance, and

(iii) expenses for the purchase of any computer technology or equipment or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in school.

Clause (iii) shall not include expenses for computer software designed for sports, games, or hobbies unless the software is predominantly educational in nature.

(B) School. The term "school" means any school which provides elementary education or secondary education (kindergarten through grade 12), as determined under State law.

(C) Computer technology or equipment. The term 'computer technology or equipment' means computer software (as defined by section 197(e)(3)(B)), computer or peripheral equipment (as defined by section 168(i)(2)(B)), and fiber optic cable related to computer use.

(4) Time when contributions deemed made.

An individual shall be deemed to have made a contribution to a Coverdell education savings account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).

(c) Reduction in permitted contributions based on adjusted gross income.

(1) In general.

In the case of a contributor who is an individual, the maximum amount the contributor could otherwise make to an account under this section shall be reduced by an amount which bears the same ratio to such maximum amount as-

(A) the excess of-

(i) the contributor's modified adjusted gross income for such taxable year, over

(ii) \$95,000 (\$190,000 in the case of a joint return), bears to

(B) \$15,000 (\$30,000 in the case of a joint return).

(2) Modified adjusted gross income.

For purposes of paragraph (1) , the term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911 , 931 , or 933 .

(d) Tax treatment of distributions.

(1) In general.

Any distribution shall be includible in the gross income of the distributee in the manner as provided in section 72 .

(2) Distributions for qualified education expenses.

(A) In general. No amount shall be includible in gross income under paragraph (1) if the qualified education expenses of the designated beneficiary during the taxable year are not less than the aggregate distributions during the taxable year.

(B) Distributions in excess of expenses. If such aggregate distributions exceed such expenses during the taxable year, the amount otherwise includible in gross income under paragraph (1) shall be reduced by the amount which bears the same ratio to the amount which would be includible in gross income under paragraph (1) (without regard to this subparagraph) as the qualified education expenses bear to such aggregate distributions.

(C) Coordination with American opportunity and lifetime learning credits and qualified tuition programs. For purposes of subparagraph (A)-

(i) Credit coordination. The total amount of qualified education expenses with respect to an individual for the taxable year shall be reduced-

(I) as provided in section 25A(g)(2), and

(II) by the amount of such expenses which were taken into account in determining the credit allowed to the taxpayer or any other person under section 25A.

(ii) Coordination with qualified tuition programs. If, with respect to an individual for any taxable year-

(I) the aggregate distributions during such year to which subparagraph (A) and section 529(c)(3)(B) apply, exceed

(II) the total amount of qualified education expenses (after the application of clause (i)) for such year,

the taxpayer shall allocate such expenses among such distributions for purposes of determining the amount of the exclusion under subparagraph (A) and section 529(c)(3)(B).

(D) Disallowance of excluded amounts as deduction, credit, or exclusion. No deduction, credit, or exclusion shall be allowed to the taxpayer under any other section of this chapter for any qualified education expenses to the extent taken into account in determining the amount of the exclusion under this paragraph.

(3) Special rules for applying estate and gift taxes with respect to account. Rules similar to the rules of paragraphs (2) , (4) , and (5) of section 529(c) shall apply for purposes of this section .

 (4) Additional tax for distributions not used for educational expenses.

(A) In general. The tax imposed by this chapter for any taxable year on any taxpayer who receives a payment or distribution from a Coverdell education savings account which is includible in gross income shall be increased by 10 percent of the amount which is so includible.

(B) Exceptions. Subparagraph (A) shall not apply if the payment or distribution is-

(i) made to a beneficiary (or to the estate of the designated beneficiary) on or after the death of the designated beneficiary,

(ii) attributable to the designated beneficiary's being disabled (within the meaning of section 72(m)(7)),

(iii) made on account of a scholarship, allowance, or payment described in section 25A(g)(2) received by the designated beneficiary to the extent the amount of the payment or distribution does not exceed the amount of the scholarship, allowance, or payment,

(iv) made on account of the attendance of the designated beneficiary at the United States Military Academy, the United States Naval Academy, the United States Air Force Academy, the United States Coast Guard Academy, or the United States Merchant Marine Academy, to the extent that the amount of the payment or distribution does not exceed the costs of

advanced education (as defined by section 2005(e)(3) of title 10 , United States Code, as in effect on the date of the enactment of this section) attributable to such attendance, or

(v) an amount which is includible in gross income solely by application of paragraph (2)(C)(i)(II) for the taxable year.

(C) Contributions returned before certain date. Subparagraph (A) shall not apply to the distribution of any contribution made during a taxable year on behalf of the designated beneficiary if-

(i) such distribution is made before the first day of the sixth month of the taxable year following the taxable year, and

(ii) such distribution is accompanied by the amount of net income attributable to such excess contribution.

Any net income described in clause (ii) shall be included in gross income for the taxable year in which such excess contribution was made.

(5) Rollover contributions.

Paragraph (1) shall not apply to any amount paid or distributed from a Coverdell education savings account to the extent that the amount received is paid, not later than the 60th day after the date of such payment or distribution, into another Coverdell education savings account for the benefit of the same beneficiary or a member of the family (within the meaning of section 529(e)(2)) of such beneficiary who has not attained age 30 as of such date. The preceding sentence shall not apply to any payment or distribution if it applied to any prior payment or distribution during the 12-month period ending on the date of the payment or distribution.

(6) Change in beneficiary.

Any change in the beneficiary of a Coverdell education savings account shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a member of the family (as so defined) of the old beneficiary and has not attained age 30 as of the date of such change.

(7) Special rules for death and divorce.

Rules similar to the rules of paragraphs (7) and (8) of section 220(f) shall apply. In applying the preceding sentence, members of the family (as so defined) of the designated beneficiary shall be treated in the same manner as the spouse under such paragraph (8) .

(8) Deemed distribution on required distribution date.

In any case in which a distribution is required under subsection (b)(1)(E) , any balance to the credit of a designated beneficiary as of the close of the 30-day period referred to in such subsection for making such distribution shall be deemed distributed at the close of such period.

(9) Military death gratuity.

(A) In general. For purposes of this section, the term "rollover contribution" includes a contribution to a Coverdell education savings account made before the

end of the 1-year period beginning on the date on which the contributor receives an amount under section 1477 of title 10, United States Code, or section 1967 of title 38 of such Code, with respect to a person, to the extent that such contribution does not exceed-

(i) the sum of the amounts received during such period by such contributor under such sections with respect to such person, reduced by

(ii) the amounts so received which were contributed to a Roth IRA under section 408A(e)(2) or to another Coverdell education savings account.

(B) Annual limit on number of rollovers not to apply. The last sentence of paragraph (5) shall not apply with respect to amounts treated as a rollover by subparagraph (A).

(C) Application of section 72. For purposes of applying section 72 in the case of a distribution which is includible in gross income under paragraph (1), the amount treated as a rollover by reason of subparagraph (A) shall be treated as investment in the contract.

(e) Tax treatment of accounts.

Rules similar to the rules of paragraphs (2) and (4) of section 408(e) shall apply to any Coverdell education savings account.

(f) Community property laws.

This section shall be applied without regard to any community property laws.

(g) Custodial accounts.

For purposes of this section , a custodial account shall be treated as a trust if the assets of such account are held by a bank (as defined in section 408(n)) or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will administer the account will be consistent with the requirements of this section , and if the custodial account would, except for the fact that it is not a trust, constitute an account described in subsection (b)(1) . For purposes of this title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

(h) Reports.

The trustee of a Coverdell education savings account shall make such reports regarding such account to the Secretary and to the beneficiary of the account with respect to contributions, distributions, and such other matters as the Secretary may require. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required.