Paying for Christian Education with Tax-Free Earnings

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A Coverdell Education Savings Account (ESA) is a savings account that is set up to pay the qualified education expenses of a designated beneficiary. Contributions to an ESA are not tax-deductible (just as contributions to a Roth IRA are not deductible). However, earnings in an ESA are not taxed while they remain in the account and amounts in the account may be withdrawn tax fee as long as they are used to pay for the beneficiary's qualified education expenses and do not exceed those expenses.

Any individual who meets adjusted gross income (AGI) requirements can make a non-deductible contribution to an ESA on behalf of a child under the age of 18. A contribution of up to $2,000 per year may be made by an individual with an AGI up to $95,000 for a single tax payer and $190,000 for married tax payers. However, even if your family can't make contributions due to income restrictions, any other individual (such as a grandparent) may be able to contribute.

While a child may be the beneficiary of any number of accounts, the total contributions from all sources for any tax year cannot exceed $2,000. Also, contributions may only be made until the beneficiary turns 18.

Unlike other educational savings plans which can only be used for college the ESA may be used for qualified elementary and secondary education expenses at public, private or religious schools.

If the ESA has a balance at the time the beneficiary turns 30, the account must be closed and all unused funds must be distributed within 30 days. The portion of the distribution that represents earnings on the account will be taxable to the beneficiary and subject to a 10% penalty. However, there is more good news. The beneficiary may avoid this by rolling over the full balance to an ESA for another family member.

To illustrate the benefits of an ESA, assume a family made $2,000 contributions to an account for each of the first six years of a child's life, and then made no further contributions. The funds could grow for the next twelve years. Then using it over the next four years for college a family would be able to withdraw up to $60,000 to pay for educational expenses. Furthermore, assuming that the family is in the 25% federal tax bracket, they would save nearly $12,000 in federal income tax. (This illustration assumes use of stock index funds with average returns of 10%.)

Please note that this article highlights the benefits concerning contributions to an ESA. Neither the Alaska Conference of Seventh-day Adventists nor its representatives give legal, accounting or tax advice. Consult your own advisors as to the applicability to your particular circumstances.