NAVY FEDERAL Credit Union

Coverdell Education Savings Account Trust Agreement

Form 5305-E Under Section 530 of the Internal Revenue Code Form (Rev. March 2002)

The Grantor whose name appears on the Application is establishing a Coverdell Education Savings Trust Account (ESA) under Section 530 for the benefit of the Designated Beneficiary whose name appears on the Application exclusively to pay for the qualified elementary, secondary, and higher education expenses, within the meaning of Section 530(b)(2), of such Designated Beneficiary.

The Grantor has assigned the trust account the sum indicated on the Application.

The Grantor and the Trustee make the following agreement:

Article I

The Trustee may accept additional cash contributions, provided the Designated Beneficiary has not attained the age of 18 as of the date such contributions are made. Contributions by an individual contributor may be made for the tax year of the Designated Beneficiary by the due date of the beneficiary's tax return for that year (excluding extensions). Total contributions that are not rollover contributions described in Section 530(d)(5) are limited to $2,000 for the tax year. In the case of an individual contributor, the $2,000 limitation for any year is phased out between modified adjusted gross income (MAGI) of $95,000 and $110,000. For married individuals filing jointly, the phase-out occurs between modified AGI of $190,000 and $220,000. Modified AGI is defined in Section 530(c)(2).

Article II

No part of the trust account funds may be invested in life insurance contracts, nor may the assets of the trust account be commingled with other property except in a common trust fund or a common investment fund (within the meaning of Section 530(b)(1)(D)).

Article III

1. Any balance to the credit of the Designated Beneficiary on the date on which he or she attains age 30 shall be distributed to him or her within 30 days of such date.
2. Any balance to the credit of the Designated Beneficiary shall be distributed within 30 days of his or her death unless the designated death beneficiary is a Family Member of the Designated Beneficiary and is under the age of 30 on the date of death. In such case, that Family Member shall become the Designated Beneficiary as of the date of death.

Article IV

The Grantor shall have the power to direct the Trustee regarding the investment of the amount listed on the Application assigned to the trust account (including earnings thereon) in the investment choices offered by the Trustee. The Responsible Individual, however, shall have the power to redirect the Trustee regarding the investment of such amounts, as well as the power to direct the Trustee regarding the investment of all additional contributions (including earnings thereon) to the trust account. In the event that the Responsible Individual does not direct the Trustee regarding the investment of additional contributions (including earnings thereon), the initial investment direction of the Grantor also will govern all additional contributions made to the trust account until such time as the Responsible Individual otherwise directs the Trustee. Unless otherwise provided in this Agreement, the Responsible Individual also shall have the power to direct the Trustee regarding the administration, management, and distribution of the account.

Article V

The Responsible Individual named by the Grantor shall be a parent or guardian of the Designated Beneficiary. The trust account shall have only one Responsible Individual at any time. If the Responsible Individual becomes incapacitated or dies while the Designated Beneficiary is a minor under state law, the successor Responsible Individual shall be the person named to succeed in that capacity by the preceding Responsible Individual in a witnessed writing or, if no successor is so named, the successor Responsible Individual shall be the Designated Beneficiary's other parent or successor guardian. Unless otherwise directed by checking the option on the Application, at the time that the Designated Beneficiary attains the age of majority under state law, the Designated Beneficiary becomes the Responsible Individual. If a Family Member under the age of majority under state law becomes the Designated Beneficiary by reason of being a named death beneficiary, the Responsible Individual shall be such Designated Beneficiary's parent or guardian.

Article VI

See the Application and Section 10.03 of this Agreement for information regarding the Responsible Individual's ability to change the Designated Beneficiary named by the Grantor.

Article VII

1. The Grantor agrees to provide the Trustee with all information necessary to prepare any reports required by Section 530(h).
2. The Trustee agrees to submit to the Internal Revenue Service (IRS) and Responsible Individual the reports prescribed by the IRS.

Article VIII

Notwithstanding any other articles that may be added or incorporated, the provisions of Articles I through III will be controlling. Any additional articles inconsistent with Section 530 and the related Regulations will be invalid.

Article IX

This Agreement will be amended as necessary to comply with the provisions of the Code and the related Regulations. Other amendments may be made with the consent of the Grantor and the Trustee whose signatures appear on the Application.

Article X

10.01 *Notices and Change of Address:* Any required notice regarding this Coverdell ESA will be considered effective when the Trustee mails it to the last address of the intended recipient that the Trustee has in its records. Any notice to be given to the Trustee will be considered effective when the Trustee actually receives it. The Responsible Individual must notify the Trustee of any change of address.

10.02 *Representations and Responsibilities:* The Grantor and the Responsible Individual represent and warrant to the Trustee that any information the Grantor and Responsible Individual have given or will give the Trustee with respect to this Agreement is complete and accurate. Further, the Grantor and the Responsible Individual agree that any directions they give the Trustee or action they take will be proper under this Agreement and that the Trustee is entitled to rely upon any such information or directions. If the Trustee fails to receive directions regarding any transaction, receives ambiguous directions regarding any transaction, or if the Trustee, in good faith, believes that any transaction requested is in dispute, the Trustee reserves the right to take no action until further clarification acceptable to the Trustee is received from the Responsible Individual or the appropriate government or judicial authority.

The Trustee shall not be liable for acting upon any instructions given by the Responsible Individual named on the Application prior to the time the Trustee receives appropriate written notice that the Designated Beneficiary has met the requirements for assuming control of the Coverdell ESA, or that a new Responsible Individual has been appointed. The Trustee shall not be responsible for losses of any kind that may result from the Grantor's and Responsible Individual's directions to it or the Grantor's and Responsible Individual's actions, or failures to act. The Grantor and Responsible Individual agree to reimburse the Trustee for any loss the Trustee may incur as a result of such directions, actions, or failures to act. The Trustee has no duty to determine whether the contributions or distributions with respect to this Coverdell ESA comply with the Code, Regulations, rulings, or this Agreement, and shall not be responsible for any penalties, taxes, judgments, or expenses of the Designated Beneficiary or any Grantor to this Coverdell ESA.

By performing services under this agreement, the Trustee is acting as the Responsible Individual's agent. Unless section 10.04(b) of the agreement applies, the Grantor, Responsible Individual, and Designated Beneficiary acknowledge and agree that nothing in this agreement will be construed as conferring fiduciary status upon the Trustee. The Trustee will not be required to perform any additional services unless specifically agreed to

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under the terms and conditions of this agreement, or as required under the Code and the regulations promulgated thereunder with respect to Coverdell ESAs. The Designated Beneficiary, Grantor, and Responsible Individual agree to indemnify and hold the Trustee harmless for any and all claims, actions, proceedings, damages, judgments, liabilities, costs, and expenses, including attorney's fees arising from or in connection with this agreement.

Notwithstanding anything in this Agreement to the contrary, the Trustee may establish a policy permitting someone other than the Designated Beneficiary's parent or legal guardian to serve as Responsible Individual, provided the individual is not prohibited by law from serving in that capacity and fulfilling his or her obligations under this Agreement.

To the extent written instructions or notices are required under this agreement, the Trustee may accept or provide such information in any other form permitted by the Code or applicable regulations, including, but not limited to, electronic communication.

10.03 *Beneficiary(ies):*

1. Unless indicated otherwise on the Application, the Responsible Individual may not change the Designated Beneficiary. If the Grantor has indicated on the Application that the Responsible Individual may change the beneficiary designated under this Agreement and the Responsible Individual chooses to do so, the Responsible Individual must designate a member of the family (as defined in Section 529(e)(2)) of the existing Designated Beneficiary. This designation can only be made on a form prescribed by the Trustee.
2. The Grantor or Responsible Individual may name one or more person or entity as death beneficiary of this Coverdell ESA. This designation can only be made on a form prescribed by the Trustee, and it will only be effective when it is filed with the Trustee during the lifetime of the Designated Beneficiary. Each beneficiary designation filed with the Trustee will cancel all previous ones unless the beneficiary designation specifies otherwise. The consent of a death beneficiary shall not be required in order to revoke a death beneficiary designation. If both primary and contingent death beneficiaries have been named, and no primary death beneficiary survives the Designated Beneficiary, the contingent death beneficiaries will acquire the designated share of this Coverdell ESA. If a death beneficiary is not designated with respect to this Coverdell ESA, or if all the primary and contingent death beneficiaries predecease the Designated Beneficiary, the Designated Beneficiary's estate will be the death beneficiary.

   If the Designated Beneficiary dies before receiving all the amounts in this Coverdell ESA, the Trustee will have no obligation to pay to the death beneficiaries until such time the Trustee is notified of the Designated Beneficiary's death by receiving a valid death certificate. Any balance remaining in the Coverdell ESA upon the death of the Designated Beneficiary will be distributed within 30 days of the Designated Beneficiary's death, unless a qualified family member under age 30 is named as a death beneficiary. If the death beneficiary is a qualified family member under age 30, that individual will become the Designated Beneficiary as of the original Designated Beneficiary's date of death. Qualified family members are defined in IRC Section 529(e)(2).

10.04 *Investment of Amounts in the Coverdell ESA:* The Responsible Individual has exclusive responsibility for and control over the investment of the assets in the Coverdell ESA. All transactions shall be subject to any and all restrictions or limitations, direct or indirect, which are imposed by the Trustee's charter, articles of incorporation, or bylaws; any and all applicable federal and state laws and regulations; the rules, regulations, customs, and usages of any exchange, market, or clearing house where the transaction is executed; the Trustee's policies and practices; and this Agreement. After the death of the Designated Beneficiary, the Responsible Individual for the successor Designated Beneficiary shall have the right to direct the investment of the Coverdell ESA assets, subject to the same conditions that applied during the original Designated Beneficiary's lifetime under this Agreement (including, without limitation, Section 10.02 of this article). The Trustee assumes no responsibility for rendering investment advice with respect to the Coverdell ESA, nor will the Trustee offer any opinion or judgment on matters concerning the value or suitability of any investment or proposed investment for the Coverdell ESA. In the absence of instructions from the Responsible Individual, or if the instructions are not in a form acceptable to the Trustee, the Trustee shall have the right to hold any uninvested amounts in cash and shall have no responsibility to invest uninvested cash unless and until directed by the Responsible Individual. The Trustee will not exercise the voting rights and other shareholder rights with respect to investments in the Coverdell ESA unless the Responsible Individual provides timely written directions acceptable to the Trustee.

The Responsible Individual will select the type of investment for the Coverdell ESA assets, provided, however, that the selection of investments shall be limited to those types of investments that the Trustee is authorized by its charter, articles of incorporation, or bylaws to offer, and does in fact offer for investment in Coverdell ESAs.

10.05 *Termination:* Either the Trustee or the Responsible Individual may terminate this Agreement at any time by giving written notice to the other. The Trustee can resign as Trustee at any time effective 30 days after mailing written notice of its resignation to the Responsible Individual. Upon receipt of that notice, the Responsible Individual must make arrangements to transfer the Coverdell ESA to another financial organization. If the Responsible Individual does not complete a transfer of the Coverdell ESA within 30 days from the date the Trustee mails the notice to the Responsible Individual, the Trustee has the right to transfer the Coverdell ESA assets to a successor Coverdell ESA trustee or custodian that the Trustee chooses in its sole discretion, or the Trustee may pay the Coverdell ESA balance to the Designated Beneficiary in a single sum. The Trustee shall not be liable for any actions or failures to act on the part of any successor trustee or custodian, nor for any tax consequences the Designated Beneficiary may incur that result from the transfer or distribution of the Coverdell ESA assets pursuant to this section.

If this Agreement is terminated, the Trustee may hold back from the Coverdell ESA a reasonable amount of money that it believes is necessary to cover any one or more of the following:

- Any fees, expenses, or taxes chargeable against the Coverdell ESA;
- Any penalties associated with the early withdrawal of any savings instrument or other investment in the Coverdell ESA.

If the Trustee is required to comply with Section 1.408-2(e) of the Treasury Regulations and fails to do so, or the Trustee is not keeping the records, making the returns, or sending the statements as are required by forms or Regulations, the IRS may, after notifying the Responsible Individual or the Designated Beneficiary, require that a substitute trustee or custodian be appointed.

10.06 *Successor Trustee:* If the Trustee is merged with another organization (or comes under the control of any federal or state agency), or if the entire organization (or any portion that includes the Coverdell ESA) is bought by another organization, that organization (or agency) shall automatically become the trustee or custodian of the Coverdell ESA, but only if it is the type of organization authorized to serve as a Coverdell ESA trustee or custodian.

10.07 *Amendments:* The Trustee shall have the right to amend this Agreement at any time. Any amendment the Trustee makes to comply with the Code and related Regulations does not require the consent of either the Responsible Individual or the Grantor. Notwithstanding anything in this Agreement to the contrary, other amendments may be made with the consent of the Responsible Individual. The Responsible Individual will be deemed to have consented to any other amendment unless, within 30 days from the date the Trustee mails the amendment, the Responsible Individual notifies the Trustee in writing that the Responsible Individual does not consent.

10.08 *Withdrawals or Transfers:* All requests for withdrawal or transfer will be in writing on a form provided by or acceptable to the Trustee. The method of distribution must be specified in writing or in any other method acceptable to the Trustee. Withdrawals will be subject to all laws and regulations, including, but not limited to, possible early distribution penalty taxes, penalties, or withholding requirements.

10.09 *Transfers from Other Plans:* The Trustee can receive amounts transferred to the Coverdell ESA from the custodian or trustee of another Coverdell ESA.

10.10 *Liquidation of Assets:* The Trustee has the right to liquidate assets in the Coverdell ESA if necessary to make distributions or to pay fees, expenses, or taxes properly chargeable against the Coverdell ESA. If the Responsible Individual fails to direct the Trustee as to which assets to

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liquidate, the Trustee will decide in its complete and sole discretion, and the Responsible Individual agrees not to hold the Trustee liable for any adverse consequences that result from the Trustee's decision.

10.11 *Restrictions on the Fund:* Neither the Responsible Individual, the Designated Beneficiary (nor anyone acting on behalf of the Designated Beneficiary), the Grantor, nor any contributor may sell, transfer, or pledge any interest in the Coverdell ESA in any manner whatsoever, except as provided by law or this Agreement.

The assets in the Coverdell ESA shall not be responsible for the debts, contracts, or torts of the Responsible Individual, the Designated Beneficiary, the Grantor, or any person entitled to distributions under this Agreement.

10.12 *What Law Applies:* This Agreement is subject to all applicable federal and state laws and regulations. If it is necessary to apply any state law to interpret and administer this Agreement, the law of the Trustee's domicile shall govern.

If any part of this Agreement is held to be illegal or invalid, the remaining parts shall not be affected. Neither the Responsible Individual's nor the Trustee's failure to enforce at any time or for any period of time any of the provisions of this Agreement shall be construed as a waiver of such provisions or the parties' right thereafter to enforce each and every such provision.

Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of Form

Form 5305-E is a model trust account agreement that meets the requirements of Section 530(b)(1) and has been pre-approved by the IRS. A Coverdell ESA is established after the form is fully executed by both the Grantor and the Trustee. This account must be created in the United States for the exclusive purpose of paying the qualified elementary, secondary, and higher education expenses of the Designated Beneficiary.

If the model account is a custodial account, see Form 5305-EA, *Coverdell Education Savings Custodial Account.*

Do not file Form 5305-E with the IRS. Instead, the Depositor must keep the completed form in its records.

Definitions

Trustee: The Trustee must be a bank or savings and loan association, as defined in Section 408(n), or any person who has the approval of the IRS to act as Trustee. Any person who may serve as a Trustee of a Traditional IRA may serve as the Trustee of a Coverdell ESA.

Grantor: The Grantor is the person who establishes the trust account.

Designated Beneficiary: The Designated Beneficiary is the individual on whose behalf the trust account has been established.

Family Member: Family members of the Designated Beneficiary include his or her spouse, child, grandchild, sibling, parent, niece or nephew, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law, and the spouse of any such individual. A first cousin, but not his or her spouse, is also a "family member."

Responsible Individual: The Responsible Individual, generally, is a parent or guardian of the Designated Beneficiary and must be a Navy Federal Credit Union Member. However, under certain circumstances, the Responsible Individual may be the Designated Beneficiary.

Identification Numbers

The Grantor's and Designated Beneficiary's Social Security Numbers will serve as their identification numbers. If the Grantor is a non-resident alien and does not have an identification number, write "Foreign" on the return for which is filed to report the Grantor's information. The Designated Beneficiary's Social Security Number is the identification number of his or her Coverdell ESA. If the Designated Beneficiary is a non-resident alien, the Designated Beneficiary's individual taxpayer identification number is the identification number of his or her Coverdell ESA. An employer identification number (EIN) is required only for a Coverdell ESA for which a return is filed to report unrelated business income. An EIN is required for a common fund created for Coverdell ESAs.

Specific Instructions

Note: *The age limitation restricting contributions, distributions, rollover contributions, and change of beneficiary are waived for a designated beneficiary with special needs*.

Article X: Article X and any that follow may incorporate additional provisions that are agreed to by the Grantor and Trustee to complete the agreement. They may include, for example, provisions relating to: definitions, investment powers, voting rights, exculpatory provisions, amendment and termination, removal of the Trustee, Trustee's fees, state law requirements, treatment of excess contributions, and prohibited transactions with the Grantor, Designated Beneficiary, Responsible Individual, etc. Attach additional pages as necessary.

Optional Provisions in Article V and Article VI: Form 5305-E may be reproduced in a manner that provides only those optional provisions offered by the Trustee.

Disclosure Statement

Requirements of a Coverdell ESA

A. *Cash Contributions*—A Coverdell ESA contribution must be in cash. Stock certificates will not be allowed.

B. *Maximum Contribution*—The total amount that may be contributed to any and all Coverdell ESAs on behalf of a Designated Beneficiary is $2,000 per year, excluding rollover and transfer contributions.

Contributions may not be made to a Coverdell ESA after the Designated Beneficiary's 18th birthday, except in the case of a special needs beneficiary.

The Coverdell ESA contribution that may be made by a Grantor is further limited if the Grantor's modified adjusted gross income (MAGI) exceeds $190,000 and he or she is a married individual filing jointly ($95,000 for single taxpayers). Married individuals filing jointly with MAGI exceeding $220,000 may not fund a Coverdell ESA. Single individuals with MAGI exceeding $110,000 may not fund a Coverdell ESA. The MAGI limits apply only to Grantors that are individuals.

If the Grantor is married filing jointly with MAGI between $190,000 and $220,000, the maximum Coverdell ESA contribution is determined as follows: (1) subtract the Grantor's MAGI from $220,000, (2) divide the difference by $30,000, and (3) multiply the result in step (2) by $2,000. For example, if the Grantor's MAGI is $205,000, the maximum Coverdell ESA contribution that may be made by such Grantor is $1,000. This amount is determined as follows: [($220,000 minus $205,000) divided by $30,000] multiplied by $2,000.

If the Grantor is a single tax filer with MAGI between $95,000 and $110,000, the maximum Coverdell ESA contribution is determined as follows: (1) subtract the Grantor's MAGI from $110,000, (2) divide the difference by $15,000, and (3) multiply the result in step (2) by $2,000. For example, if the Grantor's MAGI is $98,000, the maximum Coverdell ESA contribution that may be made by such Grantor is $1,600. This amount is determined as follows: [($110,000 minus $98,000) divided by $15,000] multiplied by $2,000.

The Coverdell ESA contribution that may be made by a Grantor is not limited by contributions made by the Grantor to Traditional or Roth IRAs. In addition, there is no earned income requirement to be eligible to contribute to a Coverdell ESA. There is no requirement that the Grantor be related to the Designated Beneficiary in order to make contributions. In addition, the Designated Beneficiary may contribute to his or her own Coverdell ESA.

C. *Eligible Trustees*—The Trustee of the Coverdell ESA must be a bank, savings and loan association, credit union, or person approved by the Secretary of the Treasury.

D. *Commingling Assets*—The assets of the Coverdell ESA cannot be commingled with other property except in a common trust fund or common investment fund.

E. *Life Insurance*—No portion of the Coverdell ESA may be invested in life insurance contracts.

F. *Collectibles*—The assets of the Coverdell ESA may not be invested in collectibles (within the meaning of Internal Revenue Code (IRC) Sec. 408(m)). A collectible is defined as any work of art, rug or antique, metal or gem, stamp or coin, alcoholic beverage, or other tangible personal property specified by the IRS. However, specially minted United States gold and silver bullion coins and certain state-issued coins are permissible investments. Beginning January 1, 1998, platinum coins and certain gold, silver, platinum, or palladium bullion (as described in IRC Sec. 408(m)(3)) are also permitted as Coverdell ESA investments.

G. *Required Distributions*—Except in the case of a special needs beneficiary, the assets of the Coverdell ESA are required to be distributed to the Designated Beneficiary within 30 days of the Designated Beneficiary's attainment of age 30. The Designated Beneficiary will be subject to both

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income tax and an additional 10 percent tax on the portion of the distribution that represents earnings, if the Designated Beneficiary does not have any qualified education expenses in that year.

Any balance remaining in the Coverdell ESA upon the death of the Designated Beneficiary shall be distributed within 30 days of the Designated Beneficiary's death, unless a death beneficiary is named and the death beneficiary is a qualified family member under age 30. If the death beneficiary is a qualified family member under age 30, that individual will become the Designated Beneficiary as of the date of death.

Qualified family members include the Designated Beneficiary's child, grandchild, or stepchild, brother, sister, stepbrother, or stepsister, nephew or niece, parents, stepparent, or grandparents, uncle or aunt, spouses of all the family members listed above, cousin, and the designated beneficiary's spouse.

H. *Responsible Individual*—The Responsible Individual is generally the parent or guardian of the Designated Beneficiary and must be a Navy Federal Credit Union Member. However, the financial organization may establish a policy that permits someone other than the Designated Beneficiary's parent or legal guardian to serve as the Responsible Individual. Unless otherwise indicated on the Application, the Responsible Individual may not change the Designated Beneficiary. If the Grantor has indicated on the Application that the Responsible Individual may change the Designated Beneficiary, the Responsible Individual may change the Designated Beneficiary to another member of the Designated Beneficiary's family. The Responsible Individual shall perform the following duties:

1. Receive a copy of the plan agreement and disclosure statement.
2. Direct the Trustee regarding the investment of contributions, including the ability to redirect the investment of the initial contribution.
3. Direct the Trustee regarding the administration, management, and distribution of the account, unless the plan agreement indicates otherwise.
4. Name a successor Responsible Individual if the need arises.
5. Notify the Trustee of any address change for the individuals identified on the plan agreement.
6. Remove excess contributions made to the Coverdell ESA.

Income Tax Consequences of Establishing a Coverdell ESA

A. *Contributions Not Deducted*—No deduction is allowed for Coverdell ESA contributions, including transfer and rollover contributions.

B. *Contribution Deadline*—The deadline for making a Coverdell ESA contribution is the Grantor's tax return due date (not including extensions). The Grantor may designate a contribution as a contribution for the preceding taxable year in a manner acceptable to the Trustee. For example, if the Grantor is a calendar-year filer and makes a Coverdell ESA contribution on or before the tax filing deadline, the contribution is considered to have been made for the previous tax year if the Grantor designates it as such.

C. *Excess Contributions*—An excess contribution is any amount that is contributed to the Coverdell ESA that exceeds the eligible contribution limit. If the excess is not corrected timely, an additional penalty tax of six percent will be imposed on the excess amount. The procedure for correcting the excess is determined by the timeliness of the correction as identified below.

1. *Removal Before the Deadline*—The Responsible Individual should remove the excess contribution along with the earnings attributable to the excess, before June 1 of the year following the year for which the excess was made. An excess withdrawn by this deadline is not taxable upon distribution, but the Designated Beneficiary must include the earnings attributable to the excess in his or her taxable income for the year in which the excess contribution was made. The six percent excess contribution penalty tax will be avoided.
2. *Failure to Remove Before the Deadline*—Excess Coverdell ESA contributions that are not removed before June 1 of the year following the year for which the excess was made, are treated as contribution for the next calendar year. If, however, additional contributions are made for that year and the total amount results in an excess, the excess amount will be subject to a six percent penalty tax if not removed timely.

   If additional contributions have been made for the next year, the amount of the excess equals the excess contribution for the current year, plus the excess contributions remaining for the preceding year, reduced by any distributions made during the current year.

   The Designated Beneficiary must file IRS form 5329 to report and remit any additional penalty taxes to the IRS.

D. *Tax-Deferred Earnings*—The investment earnings of the Coverdell ESA are not subject to federal income tax as they accumulate in the Coverdell ESA. In addition, distributions of the Coverdell ESA earnings will be free from federal income tax if the distributions are taken to pay for qualified education expenses, as discussed below.

E. *Taxation of Distributions*—The taxation of distributions from the Coverdell ESA depends on whether or not the distributions are used for qualified education expenses.

1. *Qualified Education Expenses*—The Designated Beneficiary may take tax-free distributions from a Coverdell ESA to pay for elementary, secondary, or post-secondary education expenses at an eligible educational institution. Such expenses include tuition, fees, books, supplies, special needs services, room and board, uniforms, transportation, academic tutoring, and supplementary items or services (including extended day programs). Also qualifying are expenses for the purchase of computer technology or equipment, internet access, and related services, if such technology, equipment, or services are to be used by the Designated Beneficiary or Designated Beneficiary's family during any of the years the Designated Beneficiary is in school. Qualified expenses may also include amounts contributed to a qualified tuition program.
2. *Nonqualifying Distributions*—If a Designated Beneficiary withdraws amounts from a Coverdell ESA that exceed the qualified education expenses for the same year, or the distributions are not used for qualified education expenses, a portion of the distributions will be taxable. The amount in excess of the qualified education expenses is taxable *pro rata*, based on the earnings and the basis in the account.

   In most cases of a nonqualified distribution, the taxable portion of a Coverdell ESA distribution is also subject to an additional 10 percent tax. There are several exceptions to the 10 percent tax, including distributions made payable:

   a. to a designated death beneficiary of the Coverdell ESA or to the estate of the Designated Beneficiary following the death of the Designated Beneficiary;
   b. to the Designated Beneficiary if the Designated Beneficiary is disabled;
   c. to the Designated Beneficiary if the Designated Beneficiary received a qualified scholarship, an educational assistance allowance, or an excludable payment exception, but only to the extent the distribution is not more than the amount of the scholarship, allowance, or excludable payment; and
   d. to the Designated Beneficiary as a removal of excess along with the net income attributable.
3. *American Opportunity or Lifetime Learning Credits*—A Designated Beneficiary may claim the American Opportunity Credit (formerly the Hope Credit) or Lifetime Learning Credit on his or her federal income tax return in the same year that a tax-free distribution from a Coverdell ESA is claimed, as long as the distribution(s) does/do not cover the same expenses claimed for the American Opportunity or Lifetime Learning Credit.

F. *Income Tax Withholding*—Any withdrawal from the Coverdell ESA is not subject to federal income tax withholding.

G. *Rollovers*—Coverdell ESA amounts may be rolled over to another Coverdell ESA of the same Designated Beneficiary or that of a qualified family member, provided that all the applicable rollover rules are followed. "Rollover" is a term used to describe a tax-free movement of cash to a Coverdell ESA from another Coverdell ESA. The rollover rules are generally summarized below. These transactions are often complex. If you have any questions regarding a rollover, please see a competent tax advisor.

1. *Coverdell ESA to Coverdell ESA Rollovers*—Funds distributed from a Coverdell ESA may be rolled over to another Coverdell ESA of the same Designated Beneficiary or that of a qualifying family member if the requirements of IRC Sec. 530(d)(5) are met. A proper Coverdell ESA to Coverdell ESA rollover is completed if all or part of a distribution is rolled over not later than 60 days after the distribution is received.

   Effective for distributions occurring on or after January 1, 2015, the responsible individual is permitted to roll over only one distribution from a Coverdell ESA in a 12-month period, regardless of the number of Coverdell ESAs owned by the designated beneficiary. A distribution may be rolled over to the same Coverdell ESA or to another Coverdell ESA that is eligible to receive the rollover. For more information on

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rollover limitations, you may wish to obtain IRS Publication 970, *Tax Benefits for Education*, from the IRS or refer to the IRS website at **www.irs.gov**.

2. *Qualified Family Member*—A Coverdell ESA may be rolled to another Coverdell ESA of the same Designated Beneficiary or to a Coverdell ESA maintained for the benefit of a qualified family member of the Designated Beneficiary, who is under the age of 30. The age 30 limitation does not apply to qualified family members who are special needs beneficiaries. Qualified family members of the Designated Beneficiary include the Designated Beneficiary's child, grandchild, or stepchild, brother, sister, stepbrother or stepsister, nephew or niece, parents, stepparents, grandparents, uncle or aunt, spouses of all family members listed above, cousin, and Designated Beneficiary's spouse.
3. *Rollover of Military Death Benefits*—If a designated beneficiary receives or has received a military death gratuity or a payment from the Servicemembers' Group Life Insurance (SGLI) program, the Designated Beneficiary may be able to roll over the proceeds to your Coverdell ESA. The rollover contribution amount is limited to the sum of the death benefits or SGLI payment received, less any such amount that was rolled over to a Roth IRA. Proceeds must be rolled over within one year of receipt of the gratuity or SGLI payment for deaths occurring on or after June 17, 2008. Any amount that is rolled over under this provision is considered nontaxable basis in the Coverdell ESA. Publication 970, Tax Benefits for Education, explains the rules for rolling over the military death gratuity or Servicemembers'Group Life Insurance (SGLI) and lists eligible family members.

E. *Carryback Contributions*—A contribution is deemed to have been made on the last day of the preceding taxable year if it is made by the deadline for filing the Grantor's income tax return (not including extensions), and the Grantor designates that contribution as a contribution for the preceding taxable year. For example, if the Grantor is a calendar-year filer and makes a Coverdell ESA contribution on or before April 15, the contribution is considered to have been made for the previous tax year if the Grantor designates it as such.

Limitations and Restrictions

A. *Prohibited Transactions*—If the Responsible Individual engages in a prohibited transaction with the Coverdell ESA as described in IRC Sec. 4975, the Coverdell ESA will lose its tax-exempt status and the Designated Beneficiary must generally include the value of the earnings in his or her account in his or her gross income for the year.

B. *Pledging*—If the Responsible Individual pledges any portion of the Coverdell ESA as collateral for a loan, the amount so pledged will be treated as a distribution and may be included in the Designated Beneficiary's gross income for that year to the extent that it represents earnings.

C. *Gift Tax*—Transfers of Coverdell ESA assets to a death-designated beneficiary made during the Designated Beneficiary's life and at his or her request or because of the Designated Beneficiary's failure to instruct otherwise may be subject to federal gift tax under IRC Sec. 2501.

Federal Tax Penalties

A. *Excess Contribution Penalty*—An excise tax of six percent is imposed upon any excess contribution made to a Coverdell ESA. This tax will apply each year in which an excess remains in the Coverdell ESA. An excess contribution is any contribution amount that exceeds the contribution limit, excluding rollover and direct transfer amounts. The contribution limit is $2,000 per Designated Beneficiary per year. The contribution limit may be further limited by the Grantor's MAGI as discussed previously. The excess contribution should be removed by the Responsible Individual and made payable to the Designated Beneficiary.

B. *Penalty Reporting*—The Designated Beneficiary must file IRS Form 5329 with the IRS to report and remit any penalties for excise taxes.

Other

A. *IRS Plan Approval*—The agreement used to establish this Coverdell ESA has been approved by the IRS. The IRS approval is a determination only as to form. It is not an endorsement of the plan in operation or of the investments offered.

B. *Additional Information*—You may obtain further information on Coverdell ESAs from your District Office of the IRS. In particular, you may wish to obtain IRS Publication 970, *Tax Benefits For Education*, by calling 1-800-TAX-FORM or by visiting **www.irs.gov** on the internet.

C. *Important Information About Procedures for Opening a New Account*—To help the government fight the funding of terrorism and money laundering activities, federal law requires all financial organizations to obtain, verify, and record information that identifies each person who opens an account. *What this means for you:* When you open an account, you are required to provide your name, residential address, date of birth, and identification number. We may require other information that will allow us to identify you.

Navy Federal ESA Investment Information, Fees, and Penalties

Navy Federal has no annual service fee for maintaining your ESA.
Navy Federal does require that each Navy Federal ESA beneficiary maintain a regular Navy Federal Credit Union savings account.

ESA Disclosure Statement

ESA Savings and ESA Money Market Savings Account (MMSA) Dividends: The ESA MMSA does not earn/accrue dividends on days when the account balance falls below $2,500. The ESA Jumbo MMSA will earn dividends at the ESA savings rate on balances from $0 to $99,999.99. Balances of $100,000 or greater will earn the ESA Jumbo MMSA rate. Dividends are a division and distribution of earnings among members after all expenses have been paid and the required amount has been set aside for reserves. Navy Federal also provides the Annual Percentage Yield (APY) for each dividend rate declared by the Board. Rates are subject to change weekly. Payment of all dividends is dependent on the availability of earnings at the end of the period. Dividends at Navy Federal are earned on deposits from day-of-deposit to day-of-withdrawal at the specified rate. Dividends for ESAs and ESA MMSAs are credited the last day of the period they are earned and are compounded monthly.

ESA Certificate Dividends: The ESA Certificate has a minimum balance requirement and will earn dividends for each monthly dividend period at the dividend rate and APY specified. Dividends are a division and distribution of earnings among members after all expenses have been paid and the required amount has been set aside for reserves. Payment of all dividends is dependent on the availability of earnings at the end of the period. Dividends are earned from day-of-deposit to day-of-withdrawal at the specified rate. Dividends are computed using the daily balance method by applying the daily periodic rate for the full amount in your account at the end of each day. Dividends are credited on the last calendar day of each month in which they are earned unless another dividend distribution option has been chosen. The APY assumes dividends remain in the account until maturity. Early withdrawals reduce earnings. Rates for three-year Variable Rate Certificates may change on the Certificate's anniversary dates (at 12 and 24 months) and are based on the one-year Constant Maturity Treasury (CMT). Navy Federal guarantees that the Certificate's dividend rate will never decrease more than one-half percentage point (0.50%) below the dividend rate at the time the Certificate was purchased or renewed, and there is no upper limitation on dividend rate changes.

Penalties for Early Withdrawal on ESA Certificates: (a) If the ESA Certificate term is one year *(or less)*, the amount forfeited is equal to the lesser of: (1) all dividends for 90 days on the amount withdrawn, or (2) all dividends on the amount withdrawn since the date of issuance or renewal. (b) If the ESA Certificate term is greater than one year, the amount forfeited is equal to the lesser of: (1) all dividends for 180 days on the amount withdrawn, or (2) all dividends on the amount withdrawn since the date of issuance or renewal. (c) If the ESA Certificate term is five years or greater, the amount forfeited is equal to the lesser of: (1) all dividends for 365 days on the amount withdrawn, or (2) all dividends on the amount withdrawn since the date of issuance or renewal. (d) If an early withdrawal brings your ESA Certificate account balance below the required minimum balance, your ESA Certificate will be closed and funds transferred to your: (1) other ESA Certificate account, if one exists; (2) ESA Savings or ESA MMSA account, if one exists; or (3) new ESA Savings account that we will open on your behalf, and you hereby consent to such new account opening. Alternatively, you may add funds to bring your ESA Certificate account balance back to the required minimum. Penalties may apply. (f) There are no early withdrawal penalties for qualified withdrawals on ESA Certificates. (g) Nonquallified withdrawals from ESA accounts are subject to IRS taxes and penalties.

Special and Limited Offerings: Navy Federal may offer "Limited-Time or Special Certificate Offerings." Navy Federal will provide a notice to the owner specifying the terms, conditions, or any additional requirements.

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IRA and ESA certificates, including special or limited-time offerings, are subject to IRS contribution limits. Special and limited-time offering certificates may end or be modified at any time. Penalties apply for early withdrawals from special and limited-time offering certificates. Other restrictions may apply.

Penalty Exceptions: Penalties will not be applied to any of the following: (a) withdrawals of dividend payments only, (b) withdrawals subsequent to the death of any owner of the ESA Certificate, (c) withdrawals made as a result of the voluntary or involuntary liquidation of the Credit Union, or (d) withdrawals of Required Minimum Distributions (RMDs) (Traditional and SEP IRAs only).

Maturing Certificates: At least 20 days prior to each ESA Certificate's maturity, Navy Federal will provide a notice specifying the terms under which the Credit Union proposes to renew the ESA Certificate or otherwise make the funds available to the owner. Each ESA Certificate will be automatically renewed as specified in the maturity notice unless the owner notifies Navy Federal to the contrary on or before the maturity date.

Grace Period: You have 21 calendar days from the maturity date to change the conditions under which the ESA Certificate will be renewed. During this period, the balance in the ESA Certificate will earn dividends at the prevailing offering rate. If no changes are made within this period, your ESA Certificate will be renewed as specified in the renewal notice and will continue earning at the prevailing rate.

Insurance: Separate from your share accounts, ESAs and ESA MMSAs combined with ESA Certificates are insured for up to $250,000 by the National Credit Union Administration (NCUA), a U.S. government agency.

Governing Laws: Your Navy Federal accounts are maintained and governed in accordance with federal law and the laws of the Commonwealth of Virginia, as amended. Property may be transferred to the appropriate state if there has been no activity within the time period specified by state law.

Transferability: Navy Federal ESA Certificates are not transferable, are not negotiable, and may not be pledged as collateral on a loan.

Final Payment: All non-cash purchases will be credited subject to final payment.

Change in Terms: Navy Federal reserves the right to discontinue or change the terms of ESA Certificate offerings within 30 days prior notice; however, once issued, the terms of an ESA Certificate may not be changed without the owner's consent.

Note: This account is subject to all terms and provisions defined in NFCU 602B (for ESAs).

Deposits: You may make additional deposits to ESAs or ESA MMSAs at any time. If your ESA Certificate accepts additional deposits and the ESA Certificate has not exceeded its maximum balance, additional deposits can be made by cash, check, or periodic transfer(s) from a Navy Federal savings account, checking account, or MMSA. Deposits may be held for up to five business days.

Current Rates: Dividend rates and APY may be obtained by calling Navy Federal toll-free in the U.S. at 1-888-842-6328 or visiting us online at **navyfederal.org**. For toll-free numbers when overseas, visit **navyfederal.org**. Use 1-703-255-8837 for collect international calls.

How We May Contact You: If you provide a mobile telephone number, Navy Federal has your permission to place automated non-marketing calls and text messages at that number. Message and data rates may apply. Visit **navyfederal.org** for more information. You also expressly consent that we may send email messages regarding your account to your email address.

Further Information: If you would like additional information regarding legal requirements and regulations of ESAs, you may contact any local office of the IRS. For further information regarding Navy Federal's ESA program, please call toll-free in the U.S. at 1-888-842-6328. For toll-free numbers when overseas, visit **navyfederal.org**. Use 1-703-255-8837 for collect international calls. An Account Specialist will be happy to assist you. Please visit our website at **navyfederal.org**.

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