

The AOTC provides a refundable credit worth 40% of this total, up to \$1,000. If no income tax is owed, the filer still qualifies for an AOTC up to \$1,000. If tax is owed, the balance of the credit is used to reduce the filer's tax liability.

For example, Maggie earned \$25,000 in 2010 and attended college half-time working toward her degree. Her tuition for the year was \$5,000. She owes \$1,929 in income tax. She qualifies for a maximum AOTC of \$2,500 (first \$2,000 in expenses + 25% of the next \$2,000 in expenses):

- a refundable credit of \$1,000 (40% of \$2,500), is subtracted from her maximum credit of \$2,500, leaving a balance of \$1,500;
- this reduces her \$1,929 income tax to \$429;
- She also qualifies for the Making Work Pay Credit, worth \$400.

## The Lifetime Learning Credit

For students not pursuing a degree, the Lifetime Learning Credit is available at any point in their post-secondary education. For filers to be eligible for the full credit, adjusted gross income in 2010 must be less than \$50,000 (\$100,000 if married). The credit is 20 percent of the first

\$10,000 of qualified educational expenses, up to \$2,000 per household, regardless of the number of eligible students in the family. Unlike the AOTC, this credit only reduces income tax, and won't benefit families that owe no tax.

## Special Option for Midwest Disaster Areas

Some filers have the option to use the prior year Hope Credit rules. For 2008, Congress doubled the amounts that can be claimed under the Hope Credit and the Lifetime Learning Credit for students attending educational institutions in Midwestern disaster areas. This made the Hope Credit worth a maximum of \$3,600 in these areas, compared to the AOTC maximum of \$2,500. For details on how to file and a list of counties where these rules apply, see *IRS Publication 970 "Tax Benefits for Education."*

## Claiming the AOTC and Lifetime Learning Credits

IRS Form 8863 is required to claim either credit. Form 8863 must be attached to the tax return (Form 1040 or 1040A). *For more information see IRS Publication 970 "Tax Benefits for Education."*

### Differences in Rules for the AOTC and Lifetime Learning Credit

#### American Opportunity Tax Credit

First four years post-secondary students

Student must be pursuing undergraduate degree or other educational credentials

Must be enrolled at least half-time

May not have felony convictions for possession of drugs or intent to distribute

Student is not claiming Lifetime Learning Credit

#### Lifetime Learning Credit

Students in any year of college or courses to acquire job skills

No degree or course study requirements

Enrolled in a minimum of one course

Felony drug rule does not apply

Student is not claiming AOTC



# Split Refund Option: Purchase U.S. Savings Bonds

Tax filers may directly purchase U.S. Savings Bonds in 2011 with their tax refunds. Filers can check off on their tax return that they want to use part of their tax refund to electronically purchase Savings Bonds. This is a feature of the IRS split refund policy.

## ***What are split refunds?***

The IRS provides the “split refund” option to enable tax filers receiving a refund through direct-deposit to allocate portions of the refund directly into as many as three different accounts. This is designed to make it easier for tax filers receiving substantial refunds, such as from the EIC and CTC, to take advantage of savings and asset development opportunities at the same time they file their return. Using the split refund option, a filer could directly deposit part of a tax refund into a savings account, part into an Individual Retirement Account, and the remainder into a checking account. In 2011, filers may also elect to receive the balance of their refund as a paper check mailed by the IRS.

## ***Purchase Savings Bonds through a split refund***

When filing a return in 2011, filers choosing to split their refunds may choose to purchase Savings Bonds and deposit the rest of the refund into as many as two other accounts. While Savings Bond purchasers normally have to establish an account with the U.S. Department of Treasury in

order to make a purchase, this preliminary step is not necessary when using the split refund option. The Treasury Department will mail the bonds directly to the filer. Pilot tests at free tax assistance sites in 2009 found that Savings Bonds were a popular and trusted savings option for taxpayers who might otherwise be reluctant to establish a savings account or Individual Retirement Account. The IRS provides a fact sheet on using a tax refund to purchase Savings Bonds at: [www.irs.gov/pub/irs-pdf/p4830.pdf](http://www.irs.gov/pub/irs-pdf/p4830.pdf).

*NEW!* Individuals often wish to purchase Savings Bonds in the name of a child or grandchild. This may now be done using the split refund tax return option in 2011.

Taxpayers should understand that while Savings Bonds are a risk-free investment, they are a long-term savings vehicle. They generally cannot be redeemed within a year of initial purchase, unless the owner lives in a disaster area. If the owner redeems a Savings Bond within five years of purchase, he or she loses the most recent three months of interest.

## ***What are the benefits to splitting a refund?***

Lower-income workers have many demands on their modest incomes and often lack a bank account in which to deposit savings. Receiving a large lump-sum EIC and CTC refund that averages over \$2,000, and for some is over \$5,000, provides an incentive to save, but most workers are reluctant to commit their entire tax refunds to savings.

The split refund option provides lower-income workers a convenient automatic savings mechanism that can facilitate their decision to save some of their income. Such workers usually do not have savings

opportunities such as payroll deductions for deposits into 401(k) retirement plans. Designating a portion of a substantial tax refund for savings may enable workers to save more than they could by diverting only small amounts of their paychecks to savings. Split refunds also make it easier to participate in asset-building programs such as Individual Development Accounts (IDAs) that require individual savings.

## ***How does this work?***

Tax filers direct the IRS on how to split their refund among different accounts, by submitting Form 8888, “Allocation of Refund,” with their return, providing the name of the financial institution, the filer’s account numbers and the institution’s routing transit number for direct deposits. The split refund option can be chosen whether the return is filed electronically or mailed, and it can be used with any of the IRS 1040 series of tax return forms, including the 1040-EZ. (Tax filers who want to deposit the entire amount of their refund directly into one account don’t need to use this form and will continue to designate the account on the tax return form.)

## ***Outreach resources to promote split refunds***

The flexibility of split refunds and the Savings Bond option may enable organizations seeking to build stronger linkages between free tax preparation services and asset-building to develop new services attractive to lower-income taxpayers. For example, many VITA sites now partner with a bank or credit union to help tax filers without a bank account to open a new savings account at the site. In doing so, filers can obtain a refund more quickly by filing electronically and having the IRS deposit the tax refund directly into their account.

Several organizations involved in expanding asset development opportunities for lower-income workers, including the Brookings Institution, the D2D Fund, Inc. (“Doorway to Dreams”), and the New America Foundation, previously urged the IRS to offer the split refund opportunity to tax filers and have advocated for the Savings Bond purchase option. Pilot projects with community agencies providing free tax preparation assistance that showed that low-income taxpayers often would respond to the opportunity to save when offered the flexibility of split refunds. For example, one-fifth of VITA clients accepted the opportunity to use split refunds in a pilot conducted by the Community Action Project of Tulsa County in Tulsa, OK, and deposited nearly half the amount of their refunds into savings. Over three-fourths of these workers had no savings previously.

Proponents of the split refund option actively try to increase taxpayer awareness of this opportunity. The D2D Fund, in conjunction with the United Way of America and the National Community Tax Coalition, offers a free “Guide to Split Refunds” which can be ordered at the website [www.splitrefunds.net](http://www.splitrefunds.net). The Guide provides approaches on how Tax Credit Outreach Campaigns and VITA programs can market saving through split refunds at tax time, how to modify VITA site operations and training to build in the split refund process and how to build financial institution relationships and select savings products appropriate for lower-income workers. The website provides updates on IRS forms and procedures, tax filing software issues and examples of innovative local programs offering split refund opportunities. Also see D2D’s website on the new option to purchase Savings Bonds, [www.d2dfund.org/taxtimebonds](http://www.d2dfund.org/taxtimebonds).