PD P 0051 E
Department of the Treasury
Bureau of the Public Debt
(Revised October 2008)

QUESTIONS AND ANSWERS ABOUT SERIES EE/I – EDUCATION AND SAVINGS BONDS

Question: What is the Education Tax Exclusion?

Answer: The savings bond education tax exclusion permits qualified taxpayers to exclude from their gross income all or a portion of the interest earned on the redemption of eligible Series EE and I bonds issued after 1989. You must be at least 24 years old before the bond's issue date. To qualify for this exclusion, the taxpayer, the taxpayer's spouse, or the taxpayer's dependent at certain post-secondary educational institutions must incur tuition and other educational expenses. Persons with incomes above certain thresholds may not be eligible to participate. The education tax exclusion is described in 26 U.S.C. 135.

Question: Is there a new series of bonds which must be purchased to take advantage of this feature?

Answer: No, Series EE and I bonds are used. Both types of bonds are available through financial institutions, payroll savings plans, and TreasuryDirect®.

Question: What educational expenses are eligible?

Answer: Eligible educational expenses include tuition and fees (such as lab fees and other required course expenses) required for the enrollment of or attendance by the taxpayer, or the taxpayer's spouse or dependent at an eligible educational institution. Beginning January 1, 1998, payments to qualified state tuition programs are also eligible. However, expenses relating to any course or other education involving sports, games, or hobbies are eligible only if required as part of a degree or certificate-granting program. The costs of room and board, as well as books, aren't eligible expenses. The amount of eligible expenses is reduced by the amount of any scholarships, fellowships, employer-provided educational assistance, and other tuition reduction. Eligible expenses must be incurred during the same tax year in which eligible bonds are redeemed.

Question: What qualifies as an eligible educational institution?

Answer: Post-secondary institutions, including vocational schools that meet the standards for participation in federal assistance (such as guaranteed student loan programs) qualify for the program. Proprietary institutions, such as beautician or secretarial schools, generally do not qualify.

Question: Can all outstanding bonds be used to qualify for the exclusion?

Answer: No, the education exclusion took effect on January 1, 1990, and applies only to Series EE and I bonds issued after December 31, 1989. Savings bonds issued before that date and other series of bonds (e.g., Series HH) are not eligible.

Question: Can anyone purchase these bonds and take advantage of the exclusion?

Answer: No, to exclude interest earnings on Series EE and I bonds issued after 1989, a taxpayer must be at least 24 years old before the bond's issue date. Since a bond's issue date is the first day of the month in which the taxpayer purchases the bond, the taxpayer must be 24 years old before the first day of the month in which the bond is purchased. Also, if the taxpayer is married, the taxpayer must file a joint return in order to exclude the bond interest from income.

Question: Can anyone take advantage of the interest exclusion by purchasing bonds as gifts?

Answer: No, the purpose of this program is to benefit the taxpayer(s) paying for qualified educational expenses of the taxpayer, taxpayer's spouse, or taxpayer's dependent within the meaning of Section 151 of the Internal Revenue Code. To exclude the bond interest from gross income, the bond must be in the name of the taxpayer, or in the name of the taxpayer and the taxpayer's spouse, and not in the name of the dependent. The designation of the dependent as beneficiary is permitted.

Question: **What about registering the bond in the parent and child's name as co-owners?**

Answer: For purposes of eligibility for the exclusion only, the designation of a child as co-owner with his or her parent isn't permitted. Bonds must be in the name of the taxpayer, with or without a beneficiary, or in the name of the taxpayer and the taxpayer's spouse as co-owners to exclude the bond interest from the taxpayer's gross income.

Question: **Can a child be named as beneficiary on a bond for which the interest exclusion will be taken?**

Answer: Yes. Any person may be named as beneficiary without affecting the eligibility of the bond for exclusion. A child may not be a co-owner of such a bond.

Question: **Does the education exclusion affect savings bonds that have been or are being purchased by a parent registered in the name of a child alone, or the child's name with the parent as beneficiary?**

Answer: No, the federal income tax rule that applies to such bonds remains the same. For a child under 18, see IRS Publication 929. If the child is 18 or older, all income is taxed at the child's rate. You may choose between annual or deferred reporting, taking into account your child's age and expected future earnings. However, interest earnings on such bonds don't qualify for the education savings bond tax exclusion.

Question: **I may not qualify for the Education Bond Program. Are there any other options?**

Answer: Yes, there is another way to use savings bonds to pay for your children's education expenses. Interest income on bonds purchased in a child's name alone or with a parent as beneficiary (not co-owner), can be included in the child's income each year as it accrues or deferred until the bonds are redeemed. In either case, the child will be subject to any federal income tax on the interest.

The parent may file a federal income tax return in the child's name (the child will need to have a social security number) reporting the total accrued interest on all bonds registered to the child. The intention to report savings bond interest annually, (i.e., on an accrual basis) must be noted on the return. The decision to report accrued interest income annually currently applies to all future years and can be changed only by filing IRS Form 3115 with the IRS and fulfilling other requirements outlined in IRS Publication 550, "Investment Income and Expenses."

No tax will be due unless the child has total income in a single year equal to the threshold amount that requires a return to be filed, and no further returns need to be filed until that annual income level has been reached. For children under the age of 18, unearned income (including dividends and interest) over a specified threshold amount for that age group will be taxed at the parent's rate. If the child is age 18 or older, income will be taxed at the child's rate.

With this approach, the tax liability on the bond interest is determined on an annual basis so that when the bonds are redeemed, only the current year's accrual will be subject to federal income tax. Make sure you keep complete records when using the system.

For more information on this approach, see IRS Publication 929, "Tax Rules for Children and Dependents."

Question: **Do both the principal and interest from bonds redeemed during the year have to be used for qualified educational expenses to exclude the bond interest from gross income?**

Answer: Yes, only if the taxpayer pays qualified education expenses equal to or greater than all proceeds (i.e., interest and principal) from bonds redeemed during the year can all interest accrued on such bonds be excludable from his or her gross income.

Question: What if the amount of the bond redemption proceeds exceeds the amount of the qualified educational expenses?

Answer: If the amount of the redemption proceeds from all eligible bonds redeemed during the year exceeds the amount of the qualified educational expenses paid during such year, the amount of excludable interest will be reduced *pro rata*. For example, if the bond proceeds amounted to $10,000 ($5,000 principal and $5,000 interest) and the qualified educational expenses are $8,000, the taxpayer would only be able to get an exclusion for 80 percent ($8,000/$10,000) of the interest earned, or $4,000.

Question: Are there income limitations?

Answer: Yes. In 2007, the full interest exclusion is only available for married couples filing joint returns with modified adjusted gross incomes of up to, but not including, $128,400 and for other eligible (if married filing separately, you are ineligible) filing statuses with modified adjusted gross incomes of up to, but not including, $80,600.

For 2008, the full interest exclusion is only available for married couples filing joint returns with modified adjusted gross incomes of up to but not including $130,650 and for other eligible filing statuses with modified adjusted gross incomes of up to and including $82,100.

Question: What is modified adjusted gross income?

Answer: For purposes of this program, modified adjusted gross income (AGI) means the sum of the taxpayer's adjusted gross income for the taxable year, including interest on U.S. Savings Bonds before exclusion, but taking into account the partial exclusion of social security and tier 1 railroad retirement benefits, adjustments for contributions of retirement savings, and adjustments for limitations on passive activity losses and credits. It also includes the gross income earned by citizens or residents of the U.S. living abroad and income from sources within Guam, American Samoa, the Northern Mariana Islands, and Puerto Rico.

Use the worksheet in the instruction for IRS Form 8815 to figure your modified AGI.

Question: What benefits, if any, are there for married taxpayers, who file jointly with modified adjusted gross incomes above $128,400 (or $80,600 for single filers) in 2007, and $130,650 (or $82,100 for single filers) in 2008?

Answer: For 2007, for single taxpayers, the tax exclusion begins to be reduced with a $65,600 modified adjusted gross income and is eliminated for adjusted gross incomes of $80,600 and above. For married taxpayers filing jointly, the tax exclusion begins to be reduced with a $98,400 modified adjusted gross income and is eliminated for adjusted gross incomes of $128,400 and above. Married couples must file jointly to be eligible for the exclusion.

For 2008, for single taxpayers, the tax exclusion begins to be reduced with a $67,100 modified adjusted gross income and is eliminated for modified adjusted gross incomes of $82,100 and above. For married taxpayers filing jointly, the tax exclusion begins to be reduced with a $100,650 modified adjusted gross income and is eliminated for adjusted gross incomes of $130,650 and above.

Question: **Are these income limits adjusted for inflation?**

Answer: Yes, these income limits are indexed for inflation and then rounded to the nearest multiple of $50.

Question: **How does one buy an "Education Savings Bond"?**

Answer: Since the program utilizes Series EE and I bonds, there are no differences in purchase procedures except (1) Series EE bonds must have been purchased after December 31, 1989; (2) they must be registered in the taxpayer's name alone, with or without a beneficiary, or in the name of the taxpayer and spouse (not a dependent child) as co-owners; and (3) the taxpayer must be at least 24 years old before the issue date of the bond. Otherwise, the bonds may be purchased like other Series EE or I bonds.

Question: **Where can I buy Series EE and I bonds?**

Answer: Savings bonds can be purchased through more than 40,000 financial institutions nationwide or through employers offering the Payroll Savings Plan and through TreasuryDirect® and its new payroll feature. Participants enrolled in Payroll Savings Plans who intend to use the redemption proceeds of Series EE or I bonds issued after December 31, 1989, for eligible educational expenses should review the form of registration being used to ensure it meets the requirements of the law.

Question: **Are there limitations on the denomination of the bonds used?**

Answer: No, any Series EE bond denomination, from $50 to $10,000, and any Series I bond denomination, from $50 to $5,000, is eligible for the Education Bond Program as long as other criteria for the program are met.

Question: **Is there a limitation on the number or amount of Series EE and/or I bonds one can buy?**

Answer: Yes, bonds you buy for educational savings are still subject to the Series EE bond limit of $5,000 purchase price per year per person and the I bond limit of $5,000 limit of $5,000 face value (equal to the purchase price) per social security number per year. There is no limit on the amount of bonds that you can accumulate over a lifetime.

Question: **I just realized that the bonds for our children's education are in the wrong names—theirs, not ours. As I understand it, this would not qualify for the tax exemption. Can I change the names?**

Answer: Yes, as long as the funds used to buy the bonds didn't belong to your children and the bonds are dated January 1990 or later. If I bonds or Series EE bonds purchased January 1990 or later were bought to qualify for the Education Bond Program, but were improperly registered when they were issued, the bonds may be reissued to qualify for the program. The purchaser would need to complete a PD F 4000 to get the bonds reissued.

The purchaser needs to complete and sign the form. The signature on the form needs to be guaranteed or certified by an authorized certifying officer (available at bank, trust company, or credit union). The completed form, along with the bonds, should be mailed to the Treasury Retail Securities Site (TRSS) that handles savings bond transactions for your region.

Question: **What are the redemption procedures for holders of qualified bonds?**

Answer: There are no changes in the redemption procedures for paying agents. It's the bond owner's responsibility to maintain a record of bond redemption transactions to support claims for exclusion from gross income in the year that qualified bonds are redeemed and qualifying educational expenses are incurred.

However, if an owner redeeming Series EE and/or I bonds issued after 1989 states his or her intention to exclude interest from gross income in accordance with the education exclusion, and is at the same time redeeming Series EE bonds issued prior to January 1, 1990, the paying agent should provide separate redemption values and accrued interest subtotals for bonds issued prior to January 1, 1990, and for those issued on or after January 1, 1990. If the bond owner hasn't made a record of the serial numbers, face amounts, and issue dates, the agent should advise the customer to do so before redeeming the bonds. An optional IRS Form 8818 provides instructions and space to record this information.

Question: **How does one exclude the interest income on the tax form?**

Answer: IRS Form 8815 includes the necessary worksheet and instructions for taxpayers to use in connection with tax returns.

Question: **Will the educational institution be required to verify the educational expenses of the taxpayer, taxpayer's spouse, or the taxpayer's dependent?**

Answer: Generally no, however, the taxpayer should retain receipts or canceled checks for educational expenses as part of the taxpayer's record to substantiate his or her claim to an exclusion from income of the bonds cashed.

Question: **Can one exchange Series E or EE bonds issued before January 1, 1990, for new Series EE bonds or I bonds to make them eligible?**

Answer: No, outstanding savings bonds can't be exchanged for Series EE or I bonds.

Question: **What happens if bonds dated before January 1, 1990, are redeemed and new bonds are bought with the proceeds?**

Answer: Accrued interest earnings on the bonds redeemed are taxable to the owner in the year of the redemption regardless of whether the proceeds are used to purchase new Series EE or I bonds.

FOR MORE INFORMATION

For detailed information about the rules as well as information on the income eligibility, check IRS Publication 550, “Investment Income and Expenses;” IRS Form 8815, “Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989;” and IRS Form 8818, “Optional Form to Record Redemption of Series EE and I U.S. Savings Bonds Issued After 1989.” For current recorded rate information, call 1-800-4US-BOND (1-800-487-2663).