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Comptroller
State of Illinois

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Springfield, Illinois 62706
217/782-6000

March 6, 1990

PAYROLL BULLETIN
(1-90)

TO: All State Agencies, Departments, Boards, Commissions and Universities

SUBJECT: (1) Savings Bonds for Education

(2) Elimination of $50/$75 Denomination Series EE Bonds through Payroll Deduction

SAVINGS BONDS FOR EDUCATION

Questions have been arising regarding the Savings Bonds for Education program which became effective January 1, 1990. Attached is a list of often asked questions and answers about the program. Agencies may reproduce this material to distribute to employees who may want to participate in the program.

Additional information may be obtained from:

District Director
U.S. Savings Bond Division
230 South Dearborn - Room 530
Chicago, Illinois 60604
(312) 353-6754

Interested employees may write or call. Their office hours are 8:00 to 4:30 Monday through Friday.

The Comptroller's office is not anticipating any procedural changes in the issuance of Series EE Savings Bonds in 1990 due to this program. Employees who wish to participate in the Saving Bonds for Education program should be advised that it will be up to them to know the legal guidelines. The Comptroller's office will not be advising employees on the specific requirements of the Savings Bonds for Education program.

ELIMINATION OF $50/$75 DENOMINATION SERIES EE BONDS THROUGH PAYROLL DEDUCTION

The Department of the Treasury, U.S. Savings Bond Division, has announced that as of October 1, 1990, $50 and $75 denomination U.S. Savings Bonds will no longer be available through payroll deduction. They will, however, be available through over-the-counter sales at authorized financial institutions. The Comptroller's Office will not issue any $50 or $75 bonds to anyone whose payment was from a payroll period beginning after September 30, 1990.

Employees who are presently having deductions for $50 or $75 Series EE bonds should be contacted to make them aware of this change and, if they wish to continue in the Savings Bonds program, to change their bond denomination. The change should be made as soon as possible and timed so as not to leave a constant excess balance in their account. Agencies may call (217) 782-5850 or 782-5851 to find what an employee's account balance is.

Questions regarding this bulletin should be referred to Dan Steven or Nancy Smith at (217) 782-4758.

Very truly yours,

Larry D. Roth

Larry D. Roth
Director - State Accounting

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New Tax Break Starts Next Year

Savings Bonds For Education: A Buyer's Guide

Editor's Note: Employee questions on the tax exemption on interest earnings on Savings Bonds purchased after December 31, 1989, and used for payment of education costs are sure to be frequent in the next few months. The following information is published to help answer these queries. It is important to remember that the regulations to implement this tax exclusion are still being developed and some changes to the current program may result.

Q. What is the new Education Savings Bond Program?

A. The new Education Savings Bond Program permits qualified taxpayers to exclude from their gross income all or a portion of the interest earned on eligible Series EE Savings Bonds issued after 12/31/89. To qualify for this exclusion, the bond proceeds (principal and interest) must be used to pay tuition and expenses of the taxpayer, the taxpayer's spouse or the taxpayer's dependent at certain educational institutions. In addition, there are income limitations on those eligible to participate in the program. The Education Savings Bond Program was authorized by the Technical and Miscellaneous Revenue Act of 1988.

Q. Will there be a new series of bonds which must be purchased to take advantage of the program?

A. No, Series EE Savings Bonds, widely available over-the-counter and through payroll savings plans, will be used for the program.

Q. What educational expenses are eligible for the program?

A. Eligible educational expenses include tuition and fees (such as lab fees and other course expenses) required for the enrollment of or attendance by the taxpayer, or the taxpayer's spouse or dependent, at an eligible educational institution. However, expenses relating to any course or education involving sports, games, or hobbies are eligible only if required as part of a degree or certificate granting program. Room and board are not included as eligible expenses. Eligible expenses are calculated net of scholarships, fellowships, employer-provided educational assistance, and other tuition reduction amounts and must be incurred during the same tax year in which the bonds whose interest is being excluded are redeemed.

Q. What qualifies as an eligible educational institution?

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

Q. Are all outstanding bonds able to be used in this program?

A. No, the program will take effect on January 1, 1990, and will apply only with respect to Series EE Bonds issued after December 31, 1989. No bonds issued before that date will generate excludable interest, nor will any other series of bonds (e.g., Series HH) be eligible for the program.

Q. Can anyone purchase these bonds and take advantage of the exclusion?

A. No, only bonds issued to a person who is at least 24 years old before the bonds are issued will generate excludable interest. In most cases, a taxpayer will have to be 24 years old before the first day of the month in which the taxpayer purchases the bond because bonds are issued as of the first day of the month in which purchased. Furthermore, if the taxpayer is married, the taxpayer must file a joint return in order to exclude the bond interest from income.

Q. Can anyone take advantage of the interest exclusion by purchasing bonds as gifts? (For example, grandparents who buy bonds to fund their grandchildren's education.)

A. No, the purpose of this program is to benefit the taxpayer(s) paying for qualified educational expenses of himself, his spouse, or his 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 who pays qualified educational expenses and not in the name of the dependent.

Q. What about the practice of registering the bond in the parent's and child's name as co-owners?

A. To receive the tax exemption conferred by this program, that form of registration should not be used. Bonds must be in the name of the taxpayer, or in the name of the taxpayer and the taxpayer's spouse, to exclude the bond interest from the taxpayer's gross income.

Q. Does the education bond feature affect Savings Bonds that have been or are being purchased in the name of the child alone, or the child's name with the parent as beneficiary?

A. No, the Federal income tax rule that applies to such bonds will remain the same.

Q. 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?

A. Yes, only if the taxpayer uses all proceeds (i.e., interest and principal) from bonds redeemed during the year for qualified educational expenses can all interest accrued on such bonds be excluded from his or her gross income.

Q. What if the amount of the bond redemption proceeds exceeds the amount of the qualified educational expenses?

A. If the amount of the redemption proceeds from all eligible bonds

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redeemed during the year exceeds the amount of the qualified educational expenses paid during such year, the amount of excludable interest will be reduced by a pro rata amount. 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 of the interest earned or $4,000.

Q. Are there income limitations on the program?

A. Yes, the full interest exclusion is only available for married couples filing joint returns with incomes of up to and including $60,000 (modified adjusted gross income) and for single filers with incomes of up to and including $40,000 (modified adjusted gross income).

Q. What is modified adjusted gross income?

A. For purposes of this program, modified adjusted gross income means the sum of the taxpayer's adjusted gross income for the taxable year; the partial inclusion of social security and tier 1 railroad retirement benefits; the adjustments for contributions of retirement savings; adjustments with respect to limitations of passive activity losses and credits; and without regard to this program, 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.

Q. What benefits, if any, are there for taxpayers who file jointly with modified adjusted gross incomes above $60,000 (or $40,000 for single filers)?

A. The interest exclusion benefits will phase out for joint filers with modified adjusted gross incomes of between $60,000 and $90,000 ($40,000 and $55,000 for single filers) by a decreasing percentage above the threshold income level. For example, a taxpayer filing jointly with a modified adjusted gross income (AGI) of $75,000 would only be able to take advantage of one half of the exclusion, while a taxpayer filing jointly with a modified AGI of $80,000 would only be allowed an exclusion of one third of the eligible interest income. A similar phase out plan will be employed for the single filer. Note: married individuals filing separately will not be able to take advantage of the program regardless of their incomes.

Q. Will these income limits be adjusted for inflation?

A. Yes, after 1990 these income limits will be indexed for inflation and then rounded to the nearest multiple of $50.

Q. How does one buy an "Education Savings Bond"?

A. Since the program will utilize the Series EE Bond, there are no differences in purchase procedures except (1) the bond must be purchased after December 31, 1989, (2) it must be registered in the taxpayer's name alone or in the name of the taxpayer and his or her spouse and not the dependent child's name, and (3) the taxpayer must be at least 24 years old before the issue date of the bond. Otherwise, the bonds can be purchased in the same manner as any other Series EE Bond.

Q. Where can I buy Series EE Bonds?

A. Savings Bonds can be purchased over-the-counter at more than 47,000 financial institutions nationwide or through employers offering the payroll savings plan. Participants enrolled in payroll savings plans who intend to use the redemption proceeds of Series EE 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.

Q. Will there be limitations on the denomination of the bonds used in the program?

A. No, any Series EE Bond denomination, from $50 to $10,000, will be eligible for the education bond program as long as the other criteria for the program are met.

Q. Is there a limitation on the number or amount of bonds one can buy for use in the program?

A. Yes, the standard limitation of $30,000 face value or $15,000 purchase price ($60,000/$30,000 for husband and wife holding bonds as co-owners) in bonds per year also applies to the education bond program. However, there is no limit to the amount of bonds that can be accumulated for educational expenses over time as long as these bonds do not exceed the annual purchase limitations discussed above and otherwise comply with program requirements.

Q. What are the redemption procedures for holders of qualified bonds?

A. No final decisions regarding changes to the current bond redemption procedures have been made. However, any necessary changes will be announced on a timely basis.

Q. How does one exclude the interest income on the tax form?

A. The IRS has not made any final decisions regarding this matter. However, any necessary form(s) and instructions will be available to taxpayers for use in connection with 1990 tax returns.

Q. Will educational institutions be required to verify the educational expenses of the taxpayer, taxpayer's spouse, or the taxpayer's dependent?

A. No final decisions regarding this matter have been made. However, this issue will be addressed on a timely basis.

Q. Can one exchange Series EE Bonds issued before January 1, 1990, for bonds dated after then in order to make them eligible for the program?

A. No, outstanding Savings Bonds cannot be exchanged for Series EE Bonds.

Q. What happens if bonds dated before January 1, 1990, are redeemed and new bonds bought with the proceeds?

A. Although Savings Bond redemption proceeds are used to purchase new Series EE Bonds, accrued interest earnings on the bonds redeemed are taxable to the owner in the year of the redemption.