



New IRS Split Refund Policy Encourages Workers to Save Their Refunds

What are split refunds?

In the 2007 tax filing season, the IRS will launch a new option for tax filers — called “split refund” — to enable filers receiving a refund through direct-deposit to arrange for a part of it to go directly into a savings account. 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.

The split refund option is used only to directly deposit refunds into a savings or other account. Tax filers will not be able to split their refund to deposit a part of their refund into an account and receive the rest of the refund as a paper check mailed by the IRS.

What are the benefits? Previously, filers either had to deposit all of their refund into one account or receive a paper check. This delays a worker’s decision to save and requires a separate trip to a bank or credit union to divide the refund between savings and immediate use. 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 access to the savings opportunities offered by mechanisms such as payroll deductions for deposits into 401(k) retirement plans. In addition, designating a portion of a substantial tax refund for savings may enable such workers to save more than they could by diverting only small amounts of their paychecks to savings.

By facilitating saving, the split refund option also enables low- and moderate-income workers to take greater advantage of tax benefits that reward savings, such as the Saver’s Tax Credit for deposits into retirement accounts. Split refunds also make it easier to participate in asset-building programs such as Individual Development Accounts (IDAs) that require individual savings.

How do they work?

The split refund option allows tax filers to split their refund for direct deposit into as many as three different accounts. For example, a married couple could split a joint tax refund to make deposits to each spouse’s Individual Retirement Account (IRA), with the balance going into the couple’s checking account. (Their IRA deposits may allow the couple to claim the Saver’s Tax Credit on the same tax return.)

To direct the IRS on how tax filers want a tax refund to be split among different accounts, filers will submit a new [Form 8888](#) with their return, which provides the name of the financial institution, the filer’s account number 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 won’t need to use this new form and will continue to designate the account on the tax return.)

Expanding services to help lower-income workers save

It can be hard for lower-income workers to save. They 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 \$4,000, provides an incentive for savings. However, most workers are reluctant to commit their entire tax refunds to savings. Also, a substantial segment of lower-income workers have no bank account in which to save. The split refund procedure can help address these barriers and provide new opportunities for VITA sites to engage financial institutions to open accounts for tax clients.

The flexibility of split refunds 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 send the tax refund directly into their account. With the split refund option, VITA programs could work with partners to also allow IRAs to be opened on the spot.

Similarly, free tax preparation services may be able to partner more effectively with organizations administering IDAs. The split refund option provides lower-income workers the opportunity to open an IDA account with part of their refund and still deposit the balance in a savings or checking account.

Outreach resources to promote split refunds

Several organizations, including the [Brookings Institution](#), the [D2D Fund](#), Inc. (“Doorway to Dreams”), and the [New America Foundation](#), involved in expanding asset development opportunities for lower-income workers have urged the IRS for a number of years to offer the split refund opportunity to tax filers. The D2D Fund, a non-profit organization formed to develop new ways to offer financial services to traditionally under-served low and moderate-income households, carried out 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 are now actively trying to increase taxpayer awareness of this opportunity. The D2D Fund, in conjunction with the United Way of America and the National Community Tax Coalition, is offering a free “Guide to Split Refunds” which can be ordered at its new website dedicated to split refund policies, 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 will provide updates on IRS forms and procedures, tax filing software issues and examples of innovative local programs offering split refund opportunities.