

10.06 - Savings Bonds – what are they, and how do they work?

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With additional references to material supplied by www.treasurydirect.gov



What is a savings bond?

A savings bond is a loan to the U.S. government. Repayment is guaranteed by the U.S. Treasury. When you buy a bond, you are lending money to the US government. You can buy the bond and register it in your name, or in the name of someone else — even if they’re under 18. Only the owner or co-owner can cash it in.

There are two types of bonds available for purchase, series EE and series I savings bonds, and you can buy them in an electronic format directly on the U.S. Treasury’s website, TreasuryDirect.gov.

The only way you can buy bonds made of paper, is to use your tax refund and complete IRS form 8888, but few people do that – instead those desiring to purchase US bonds buy them in electronic form through the website: <https://www.treasurydirect.gov/>

If you own old paper bonds, you can still redeem them at a financial institution.

Unlike **other bonds**, you can’t sell savings bonds to other investors or hold them in brokerage accounts.

What is the difference between a Series EE vs. Series I bond ?

There are two types of US Savings bonds Series EE and Series I. The main difference between these two is how their interest rate is set.

- **Series EE bond** purchased after May 2005 has a fixed rate and earns interest plus a guaranteed return of double the value if kept for 20 years. So, regardless of the rate, the bond gets a one-time adjustment at the 20-year mark to ensure the value doubles.
- **Series I bond** has a rate that combines a fixed rate and an inflation-adjusted rate calculated twice a year. The idea is that your money is protected from inflation, which is the overall rise in prices for goods and services.

What is the interest rate is earned on Series EE or Series I bonds?

Series EE Bonds:

- Before May 1997, Series EE bonds earned an interest, which was fixed at the time of purchase.
- Between May 1997 and April 2005, Series EE bonds that were purchased had a variable rate, which changed every six months.
- After April 2005, Series EE bonds have a fixed rate for up to 30 years. The treasury department announces that rate every May 1st and November 1st.

Recent rate SERIES EE

| Date the fixed rate was set for EE bonds | Fixed rate for EE bonds issued in the six months after that date |
|-------------------------------------------------|-------------------------------------------------------------------------|
| May 1, 2024 | 5/1/2024 to 10/31/2024 = 2.70% |

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Series I Bonds,

- the interest rate is a combination of the fixed rate AND the inflation rate, also called a “composite rate.” The current interest rate can be viewed here:

https://www.treasurydirect.gov/indiv/research/indepth/ibonds/res_ibonds_iratesandterms.htm

Series I bonds interest rate changes every six months, on May 1st and November 1st.

For years, the interest rate was below 3% annually, but starting in 2021, as inflation rose the interest on Series I bonds rose significantly. As of November 2022, the I bond composite rate was 6.89%.

Is there a Risk in buying US Savings Bonds?

Savings bonds are one of the safest investments available because they’re backed by the full faith and credit of the U.S. government. In other words, the government is on the hook for paying you back.

What is the minimum purchase?

There is a minimum purchase of \$ 25, which can be purchased in penny increments. For example, you could buy a bond for \$100.45.

Is there a maximum purchase?

Yes, you can only purchase up to \$10,000 per year for each social security number.

For how long is the money tied up?

Bonds will earn interest for thirty years. However, you can cash them in at any time. If you cash in a savings bond before five years, there is a penalty in that you lose the previous three months of interest. After five years, there is no penalty, but for EE bonds, you lose the guarantee of having your bond double in value as you need to hold them 20 years to collect on the guarantee.

When should I consider a savings bond?

A savings bond can be a fun gift to give a newborn baby or for an event whereby you are trying to encourage long-term savings. It might also be considered for investors who want to avoid risk and have a long-time frame for redemption.

What is face value? And how does it relate to the purchase of a bond?

In prior years it was possible to purchase a bond at less than its face value. For example, you could buy a \$500 bond for just \$250. That occurred because the government calculated the interest it would earn for the next 30 years, and instead of paying interest, your bond kept getting more valuable. I.e., if you cashed it in after ten years, you might get \$ 300, but if you waited the entire 30 years, you would get the \$ 500.

Now bonds are purchased at face value. The US treasury calculates the interest, and a person receives the total interest (along with the face value) when they are “redeemed” – cashed in.

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Is the Interest earned Taxable?

The tax situation is the same for both EE and I bonds.

Federal income tax: Yes

State and local income tax: No

Federal estate, gift, and excise taxes; state estate or inheritance taxes: Yes

For federal income tax, you choose whether to report earnings each year or wait to report all the earnings when the bond finishes earning interest (or when you cash it if you cash it before the end of its 30-year life).

If you use the money for qualified higher education expenses, you may not have to pay tax on the earnings.

Check out the Treasury Direct website for more information. <https://www.treasurydirect.gov/>