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A Primer on Series I Savings Bonds

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What are I Bonds?

Series I Savings Bonds (“Inflation Bonds” or “I Bonds”) are inflation-indexed bonds issued and backed by the U.S. Treasury. I Bonds accrue interest for 30 years.

How do they earn income and how are they taxed?

Interest is earned monthly and compounded semiannually, meaning the interest earned over the previous six months is added to the value of the bond. Accrued interest is paid to the owner of the bond either at maturity or when the bond is cashed in, not when it is earned.

Interest earned during a calendar year is subject to federal income tax in that year, and I bond holders receive form 1099-INT annually. Interest on I Bonds is not subject to state or local income taxes. Holders of I Bonds can elect to defer payment of Federal income taxes on the accrued interest until the bond is redeemed or matures.

How is the interest calculated?

The interest rate is a combination of a “Fixed Rate” and an “Inflation Rate” and is known as the “Combined Rate.”

The *Fixed Rate* is an annual rate and is set for the life of an I Bond. Once an I Bond is purchased, its *Fixed Rate* never changes. The current annual *Fixed Rate* for all new I Bonds is 0.00% and has been between 0.00% and 0.50% since November 2016.

The *Inflation Rate* is a semiannual rate and adjusts every May 1 and November 1 based on the six-month change in the Consumer Price Index (CPI-U) report. For example, the *Inflation Rate* used in the May-October 2022 period was determined by the change in the CPI Index from October 2021 - March 2022. The current annualized interest rate is 9.62%. For the five years prior to May 1, 2021, the annualized *Inflation Rate* was around 2.00%.

The *Combined Rate*, also a semiannual rate, is the sum of the *Fixed Rate* and the indexed *Inflation Rate* and adjusts every May 1 and November 1. The annualized *Combined Rate* for recently issued bonds (May-October 2022) is 9.62%. The guaranteed minimum *Combined Rate* is 0.00%, even if there were to be a protracted period of negative inflation (deflation). For the period of 2016-2021, the *Combined Rate* did not exceed 3.00% annually.

How do I purchase an I Bond?

I Bonds can be purchased through Treasury Direct at www.treasurydirect.gov.

How much can I buy?

An individual can buy up to \$10,000 of I Bonds each calendar year, held electronically, and an additional \$5,000 in paper bonds when purchased using your federal income tax refund (\$5,000 limit per tax return). Trusts can purchase I Bonds and parents can purchase them for their children.

When can I get my money?

I Bonds can be cashed in after holding the bond for 12 months. However, a penalty of 3 months' interest is charged if a bond is redeemed that has been held for less than five years.

Our Thoughts

- I Bonds are designed to provide returns that keep up with inflation before federal taxes.
- I Bond interest rates are most attractive when inflation rises and remains high.
- I Bond returns should decline as inflation declines and can be as low as 0.00%.
- Unless one chooses to defer the payment of Federal income taxes, some investors may not be comfortable paying taxes on interest income accrued but not yet collected, since interest on I Bonds is only collected at the time of redemption.
- This is the first time the U.S. economy has seen a protracted period of inflation since the Volker era (the late 1970s).
- If investors believe the Federal Reserve will succeed in bringing inflation down to their target of 2%, high-quality long-term bonds, both taxable and tax free, should provide most investors with better returns than I Bonds over the intermediate and long term.
- The small amount of I Bonds one can purchase annually is not meaningful for affluent individuals.

Sources: U.S. Treasury (<https://www.treasurydirect.gov/>)

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