

Advanced Savings Bond Information FAQ

Supplemental training material for the Tax Season 2010 Savings Bond Pilot

Q1: If I buy a savings bond with a co-owner, who is liable for the tax on the interest when it the bond is redeemed?

When a person redeems a savings bond, the institution paying the bond will report the interest earned on the bonds to that person AND to the IRS. The person will receive an IRS Form 1099-INT from the institution, either at the time the bonds are redeemed, or shortly after the end of the year in which the person redeemed the bonds. So, the co-owner who redeemed the bond will pay taxes on the interest.

Q2: What happens in the event of the death of one of the co-owners?

Upon the death of one of two people named in a bond's registration, any surviving person named on the bond as co-owner or beneficiary becomes the new owner. As the new owner, this person is required to include, on his or her tax return, the interest earned on the bonds for the year the bonds are redeemed or disposed of in a taxable transaction, or the bonds reach final maturity, whichever occurs first.

Q3: Once I buy a Series I Savings Bond, and the interest rate changes, does the new rate apply to my bond?

Yes. The interest rate (the composite rate) for a Series I savings bond comprises two components: the fixed rate and the semiannual inflation rate. The Bureau of Public Debt (BPD) announces a new semiannual inflation rate every May and November. But the announced rate doesn't apply to a specific Savings Bond until its next rate period begins – this ranges from zero (for bonds purchased in May and November) to five (for bonds purchased in April or October) months later. However, the fixed rate on the bond that you bought will never change. But because the semiannual inflation rate changes, the composite rate will change.

Q4: I understand that the interest rate for the Series I savings bond has 2 components. How is the adjustable (inflation) rate set?

The BPD bases the Series I bond semiannual inflation rate component on the Consumer Price Index for Urban Consumers (CPI-U), which is published by the Bureau of Labor Statistics. The Series I bond inflation rate component announced in November reflects the annualized percentage change between the unadjusted March and September CPI-U

indexes. The rate announced in May reflects the annualized percentage change between the September and March indexes. Since I bonds were introduced in September 1998, the annualized inflation rate component has ranged from a low of -5.56% to a high of 5.70%.

Q5: How often is the interest on a Series I Savings Bond accrued? And how often is the interest compounded?

The interest on the Series I Savings Bond accrues monthly, and the interest is compounded semiannually.

Q6: What is the difference between paper Series I and paper Series EE Savings Bonds?

One difference is the interest rate. The interest rate for an EE Bond is 90% of the 6-month averages of 5-year Treasury Securities market yields, while the rate for an I Bond is calculated by combining the fixed rates of return and semi-annual inflation rates based on the CPI-U as described above. Thus a Series I bond is protected from inflation while an EE bond is not. Further, a paper EE Bond is purchased for 50% of its face value (for example, a \$100 EE bond costs \$50) whereas a Series I bond is purchased at face value. An EE Bond purchased after June 2003 will take 20 years to reach face value.

Q7: When I buy a savings bond, what does the government do with that money? When I cash one, where does the money come from?

The government borrows money to cover any spending needs above and beyond what it takes in through taxes, fees and other forms of revenue. Savings Bonds are one of several ways in which the government borrows money. However, Savings Bonds are a very small percentage of the government's "public debt", which is the money the government borrows from the public. When you redeem a Savings Bond, the money comes from the same government funds which are a mix of tax receipts and borrowing.

Q8: Are there tax benefits to using Savings Bonds for educational purposes?

Yes. Under the Education Savings Bond Program you might be able to completely or partially exclude savings bond interest from Federal income tax. This can occur when you pay qualified higher education expenses at an eligible institution or state tuition plan in the same calendar year you redeem eligible I Bonds and EE Bonds issued January 1990 and later. You aren't required to indicate that you intend to use the bonds for educational purposes when you buy them, but you must make sure the program's requirements are met; some apply when you buy the bond(s). See IRS Publication 970.