Mesirow

Series I Savings Bonds

What are they and how do they fit within my financial plan?

Inflation continues at the highest rate since the early 80's and as a result different savings vehicles such as Series I Savings Bonds, or "I Bonds," are emerging in popularity. This article explains what I Bonds are, the pros and cons of investing in them, tax considerations, and how they may factor into your financial planning.

I Bonds are savings bonds from the United States Treasury that encourage Americans to save for the future while protecting their savings from inflation.1 I Bonds strive to achieve this goal by offering a combination of a fixed and variable interest rates. The fixed rate is set upon the time of purchase and stays the same throughout the life of the bond, while the variable rate is adjusted every six months by the Bureau of Labor Statistics to reflect changes in the Consumer Price Index for all Urban Consumers (CPI-U).

The fixed and variable interest rates are announced on May 1st and November 1st (or the first business day of the respective month, so April 20,2024) of every year. The fixed rate stays with the bond for the duration of its life while the variable rate changes every six months, with inflation driving the variable interest paid. The interest from the I Bond is earned monthly and compounded semiannually. Interest is then added to the bond's principal and paid out when an investor cashes in the bond, or it reaches maturity. These bonds have a 20-year maturity period plus a 10-year extended period for a total of 30 years.

How to calculate I Bond interest rates

Calculating the interest rates for I Bonds consists of knowing the fixed rate, which is set at purchase, and the variable rate (which we know changes every six months). You can calculate it using the below formula:

- Composite rate = [fixed rate + (2 x semiannual variable rate) + (fixed rate x semiannual variable rate)]

The pros and cons of I Bonds

I Bonds present themselves as a lower-risk savings vehicle. However, there are both pros and cons to I Bonds, so it is important to consider how I Bonds would fit within your current financial plan depending on your unique situation:

Pros

- I Bonds are generally a liquid investment and can be held for as little as one year and as long as 30 years
- They are viewed as a lower risk investment and have been known to achieve a relatively high yield during times of high inflation
- I Bonds are taxed at the federal level, but not the state or local level
- In certain cases, trusts, estates, and business entities can purchase I Bonds

Cons

- If an I Bond is sold before 5 years, a penalty of 3 months' interest is applied. They cannot be sold within one year of purchase. So, for example, if a bond is sold after 18 months, only 15 months' worth of interest will be received
- I Bonds can only be purchased at[TreasuryDirect.gov](TreasuryDirect.gov)
- There is a limit of $10,000 per year per SSN, with an option of purchasing an additional $5,000 (per SSN) if using an income tax refund. Theoretically, a married couple can invest up to $30,000 per year if they have a $10,000 tax refund

I Bonds offer tax reporting flexibility

Depending on your situation, you have a few options for reporting the interest incurred during the life of the bond. You can report the interest earned every year when you file your taxes OR you can defer reporting the interest until you file a federal income tax return for the year in which the first of these events occurs:

- You cash the bond and receive what the bond is worth, including the interest, or

- You give up ownership of the bond and the bond is reissued, or
- The bond will stop earning interest because it has reached final maturity

Whether you are reporting interest at the end of the bond's life or every year, you report the interest from your bonds on your federal income tax return on the same line with other interest income. Interest income can be seen on your IRS Form 1099-INT.

How to incorporate I Bonds within your financial planning

Many of our clients are asking if I Bonds is an appropriate savings vehicle. Your Mesirow Wealth Advisor can work with you to explore the pros and cons relative to your unique financial plan.

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

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