

Series EE Savings Bonds

By Lawrence N. Legg, CPA

I have found that many of my clients own Series EE (or E) bonds that were bought many years ago and which, except on occasional trips to the safe deposit box, are rarely looked at or thought about. If you own bonds that are reaching final maturity, action is needed to assure that there is no loss of interest or unanticipated current tax consequences.

Series E bonds are issued – in either paper or electronic form - at a discount of 50% of face value. For example, the issue price for a \$50 face value bond—the smallest denomination offered—is \$25. The accrued interest is added to the issue price at stated intervals and is paid only when the bond matures or is cashed. The interest on outstanding bonds ceases to accrue after final maturity. A Series E bond issued before December, '65 reaches final maturity 40 years after its issue date. A Series E bond issued after November, '65 reaches final maturity 30 years after its issue date. Series E Bonds dated May 2005 and after earn a fixed rate of interest. Bonds purchased between May 1997 and April 30, 2005, earn a variable market-based rate of return. The minimum term of ownership is one year, but a penalty is imposed if the bond is redeemed in the first five years.

One of the principal reasons for buying U.S. savings bonds is the fact that interest can build up without the need to currently report or pay tax on it. The accrued interest is added to the redemption value of the bond and is paid when the bond is eventually cashed in. Unfortunately, the law doesn't allow for this tax-free build up to continue indefinitely. For example, Series E bonds issued in January, 1979 reached final maturity after 30 years, in January, 2009. That means that not only have they stopped earning interest, but all of the accrued and as yet untaxed interest is taxable in 2009.

Owners of Series E can elect to have the interest taxed annually. If the election is made, all previously accrued but untaxed interest is also reported in the election year. In most cases, the election won't be made so that the benefits of tax deferral can be enjoyed, particularly since the income itself is not actually received until redemption. On the other hand, if the bond is owned by a taxpayer with little or no other current income, it may be beneficial make the election so as to incur the income in low or no tax years to avoid its inclusion in the future. The election, once made, applies to all bonds and for all future years - that is, the election cannot be made on a bond-by-bond or year-by-year basis.

United States Treasury Regulations permit qualified taxpayers to exclude from their gross income all or part of the interest received upon the redemption of eligible Series E bonds issued after 1989 when the bond owner pays qualified higher education expenses at an eligible institution.

You can purchase Series E bonds by going to www.TreasuryDirect.gov.

Be sure to consult with your investment and tax advisors prior to making any decisions with respect to Series E bonds.