

SAVINGS ACCOUNTS

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Financial institutions that offer savings accounts include commercial banks, savings banks, savings and loan associations, and credit unions. The institution can use some of the total amount invested to loan money to other customers (for example, as mortgages). The bank expects to earn a profit on the spread (i.e., the difference between what it pays out to depositors in interest and what it receives in interest from borrowers).

Some institutions require a minimum deposit to establish a savings account, and some require you to maintain a minimum balance. The annual rate of interest on a savings account is usually somewhat lower than that of a certificate of deposit (CD) or a money market account, but savings accounts are FDIC insured.

What are savings accounts?

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Strengths

Flexibility and liquidity

It's easy to open a savings account, and most institutions allow you access to your account through ATMs, so you can make deposits and withdrawals virtually whenever you like. Savings accounts are highly liquid because you aren't subject to penalties for withdrawals as you would be if you made early withdrawals from a CD or other term deposits.

Accounts are insured

Most savings accounts offered by chartered institutions are insured for up to \$250,000 per depositor per bank by the Federal Deposit Insurance Corporation (FDIC). Retirement accounts also are generally insured up to \$250,000. Credit unions provide comparable insurance coverage. The insurance applies to each ownership format per bank. For example, if you had an individual account, a joint account with your spouse, and a retirement account, and each account had a balance of \$250,000, all three accounts would be fully insured by the FDIC for a total of \$750,000.

Your account earns interest

Savings accounts typically pay interest. The interest is usually posted to accounts on a monthly or quarterly basis. However, the interest rate is fairly low.

Tradeoffs

Interest paid is low

Typically, you'll earn less on a savings account than you would if you had invested the same sum of money in a CD or a money market account. Interest on savings accounts is often so low that it may not compensate for the effects of inflation and taxes.

Opportunity cost

So-called safe investments involve what's known as an opportunity cost. If you invest in long-term vehicles that are more risky, you have the potential to earn better returns.

Restrictions may apply

Some financial institutions require a minimum initial deposit to open an account, and some require that you maintain a minimum balance. In addition, some institutions charge activity fees if you make more than a specified number of withdrawals within a given period.

You may be unable to write checks on the account

Check-writing privileges is one of the principal features of checking accounts, which may also pay a small amount of interest on your account. However, most savings accounts usually don't offer this service, so you might have to visit a branch office or an ATM to make withdrawals.

Tax considerations

The interest you receive from a savings account is taxable income that must be reported on your federal income tax return, and probably on your state return as well. At the end of the year, your financial institution will send you a Form 1099-INT summarizing the interest you received during the year.

Savings account with parent as trustee

You may establish a savings account for a minor child, but place the account in your name, subject to your control as trustee. The interest the child's account earns is taxable to the child, presumably at a much lower rate. However, under the law of the state in which the child resides, both of the following must apply:

- The savings account must legally belong to the child.
- The parents are not legally permitted to use any of the funds to support the child.

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