

Doerschler & Associates

Wealth Management Financial News

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Doerschler & Associates
WEALTH MANAGEMENT



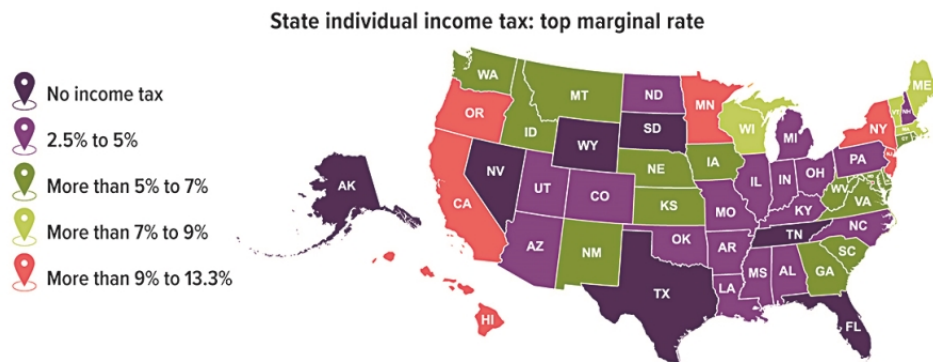
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Number of states that don't have a state or local sales tax: Delaware, Montana, New Hampshire, and Oregon

Source: Tax Foundation, February 2024

State Income Tax Across the Map

Seven states have no state income tax. Of the 43 states with a state income tax (and the District of Columbia), the top marginal income tax rate ranges from 2.5% to 13.3%. Most states (and D.C.) with an income tax have multiple tax brackets with graduated rates; 14 states have only a single tax rate. New Hampshire only taxes interest and dividends, and Washington only taxes capital gains.



Source: Tax Foundation, February 2024

Thinking of Selling Your Home? Don't Be Surprised by Capital Gains Taxes

The Taxpayer Relief Act of 1997 provided homeowners who sell their principal residence an exclusion from capital gains taxes of \$250,000 for single filers and \$500,000 for joint filers. At that time, the average price of a new home was about \$145,000, so this exclusion seemed generous and allowed more Americans to move freely from one home to another.¹ Unfortunately, the exclusion was not indexed to inflation, and what seemed generous in 1997 can be restrictive in 2024.

Capital gains taxes apply to the profit from selling a home, so they may be of special concern — and potential surprise — for older homeowners who bought their homes many years ago and might yield well over \$500,000 in profits if they sell. In some areas of the country, a home bought for \$100,000 in the 1980s could sell for \$1 million or more today.² At a federal tax rate of 15% or 20% (depending on income) plus state taxes in some states, capital gains taxes can take a big bite out of profits when selling a home. Fortunately, there are some things you can do to help reduce the taxes.

Qualifying for exclusion

In order to qualify for the full exclusion, you or your spouse must own the home for at least two years during the five-year period prior to the home sale. You AND your spouse (if filing jointly) must live in the home for at least two years during the same period. The exclusion can only be claimed once every two years. There are a number of exceptions, including rules related to divorce, death, and military service. If you do not qualify for the full exclusion, you may qualify for a partial exclusion if the main reason for the home sale was a change in workplace location, a health issue, or an unforeseeable event.

Increasing basis for lower taxes

The capital gain (or loss) in selling a home is determined through a two-part calculation. First, the selling price is reduced by direct selling costs, including certain fees and closing costs, real estate commissions, and certain costs that the seller pays for the buyer. (The amount of any mortgage pay-off is not relevant for determining capital gains.) This yields the *amount realized*, which is then reduced by the *adjusted basis*.

The basis of your home is the amount you paid for it, including certain costs related to the purchase, plus the costs of improvements that are still part of your home at the date of sale. In general, qualified improvements include new construction or remodeling, such as a room addition or major kitchen remodel, as well as repair-type work that is done as part of a larger project. For example, replacing a broken window would not increase your basis, but replacing the window as part of a project that includes replacing all

windows in your house would be eligible. This basis is adjusted by adding certain payments, deductions, and credits such as tax deductions and insurance payments for casualty losses, tax credits for energy improvements, and depreciation for business use of the home. (See hypothetical example.)

Hypothetical Example

Pete and Joanne purchased their home for \$100,000 in 1985 and sold it for \$800,000 in 2024. This is how their capital gains might be calculated.

Capital gains	Basis
\$800,000 sales price	\$100,000 purchase price
– \$50,000 direct selling costs	+ \$8,000 purchase costs
\$750,000 amount realized	+ \$52,000 improvements
– \$150,000 adjusted basis	\$160,000 total basis
\$600,000 capital gain	– \$10,000 solar energy credit
– \$500,000 capital gains exclusion	\$150,000 adjusted basis
\$100,000 taxable gains	

At a 15% rate — which applies to most taxpayers — this would cost \$15,000 in federal capital gains taxes.

This hypothetical example of mathematical principles is for illustration purposes only. Actual results will vary.

Inheriting a home

Upon the death of a homeowner, the basis of the home is *stepped up* (increased) to the value at the time of death, which means that the heirs will only be liable for future gains. In community property states, this usually also applies to a surviving spouse. In other states, the basis for the surviving spouse is typically increased by half the value at the time of death (i.e., the value of the deceased spouse's share).

Determining the capital gain on a home sale is complex, so be sure to consult your tax professional. For more information, see IRS Publication 523 *Selling Your Home*.

1) U.S. Census Bureau, retrieved from FRED, Federal Reserve Bank of St. Louis, 2024

2) CNN, January 29, 2024

Making the Most of Your Credit Card

A growing number of Americans are moving towards a "cashless" society. As a result, credit cards are being used more often than ever — especially by those with higher incomes.¹

Credit cards are no longer viewed solely as a debt instrument for cash-strapped individuals. Instead, they are prized for a variety of benefits, such as earning rewards and travel perks, protecting purchases, building credit, and gaining additional insurance coverage.

Reap the rewards

Using a rewards credit card for everyday purchases can provide you with valuable perks. Some rewards cards will offer a percentage of cash back for every dollar spent on certain purchases (e.g., dining; travel) or the ability to apply rewards towards a statement credit. Others offer travel rewards that can be used to purchase airline miles and hotel accommodations. Certain rewards cards can even provide you with entrance into VIP airport lounges and early access to purchase tickets for concerts and sporting events. Many rewards cards offer additional sign-up bonuses, such as double cash back or bonus miles/points for new customers if you charge a certain amount on the card within a specified period of time.

The disadvantages of a rewards card are that it can often come with a higher interest rate or charge an annual fee. So if you tend to carry a balance on your card, you could end up paying more in interest than you would earn in rewards. In addition, it is important to read the fine print and fully understand the terms and conditions of the rewards offered. You'll also want to periodically check in with your card issuer to see if any of the terms and/or conditions of the offer have changed.

Protect your purchases

One of the main advantages of using a credit card is that you have greater protection for your purchases than you would if you use cash or a debit card. If your credit card is lost or stolen, you generally are liable for no more than \$50 in fraudulent/unauthorized charges. Credit cards also come with additional fraud protection in the form of fraud alerts that are sent immediately to you by email or text message when suspicious charges are detected.

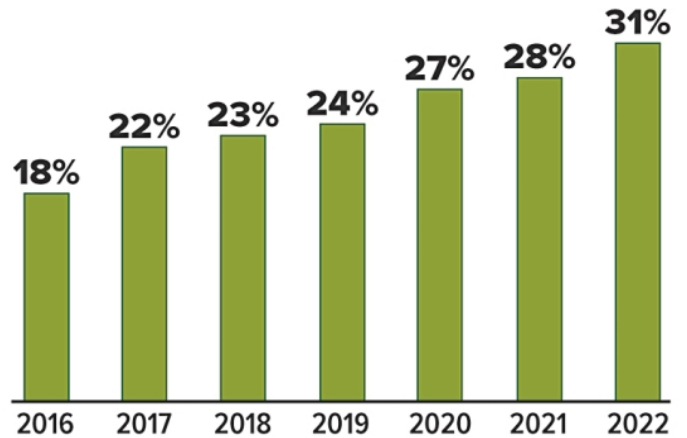
Your credit card may also provide extended warranties and/or extra purchase protection for high-cost items bought with the card, such as a TV or laptop.

Build your credit

Using a credit card is an excellent way to build credit and improve your credit score. There are a variety of factors that go into determining your credit score, such as your payment history, outstanding debt, and how close your balances are to their account limits.

In order to use a credit card to build and/or improve your credit, you should be sure to consistently pay your full monthly balance on time and keep your balance below your credit limit.

Share of payments made by credit card



Source: Federal Reserve, 2023

Gain additional insurance coverage

Many credit cards provide you with additional insurance coverage for particular circumstances. For example, if you use your card to rent a car, you may be covered by auto rental insurance to protect you in case of damage or theft. If you use your card to purchase a trip, it may offer travel interruption insurance if your trip is canceled for a covered reason. Your credit card may even provide coverage for a lost or damaged cell phone if you purchased your cell phone or pay your cell phone bill with your card.

Use your card wisely

The key to making the most of your credit card is to use your card wisely and avoid falling into common credit card traps. Here are three tips for using your credit card responsibly:

- Only charge what you can afford and pay the full balance due each month.
- Avoid missing payments by signing up for automatic payments and account alerts.
- Try to keep your balance well below your credit limit.

1) Federal Reserve, 2023

What's Your Real Return?

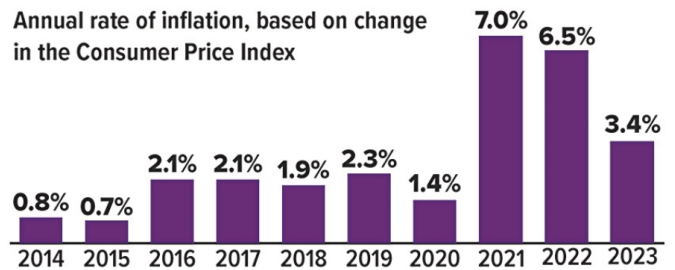
As an investor, you probably track the return on your investments. But it's likely that you look at the *nominal return*, which is the percentage increase or decrease in the value of an investment over a given period of time, usually expressed as an annual return. To estimate actual income or growth potential in order to target financial goals, such as a certain level of retirement income, it's important to consider the *real return*, which includes the effects of taxes and inflation.

Let's say you want to purchase a bank-issued certificate of deposit (CD), because you like the lower risk and fixed interest rate that a CD can offer. CD rates have risen substantially with the Federal Reserve's aggressive increases in the federal funds rate, so let's say you find a CD that offers 5% annual interest. That could be attractive. However, if you're taxed at the 22% federal income tax rate, 1.1% will be gobbled up by federal income tax on the interest.

That still leaves an interest rate of 3.9%, but you should consider the purchasing power of the interest. For example, inflation slowed to 3.4% in 2023 after hitting 40-year highs in 2021 and 2022 (see chart). But a 3.4% inflation rate would leave a real return of just 0.5%. If inflation slows further, the real return on this hypothetical CD would increase. However, if the Fed were to lower the benchmark federal funds rate in response, rates on CDs and other fixed-income investments might decline, reducing the real return on future CD and fixed-income purchases.

Eroding Purchasing Power

Annual rate of inflation, based on change in the Consumer Price Index



Source: U.S. Bureau of Labor Statistics, 2024

This hypothetical example doesn't represent the performance of any specific investment, but it illustrates the importance of understanding what you're actually earning after taxes and inflation. In some cases, the lower risk offered by an investment may be appealing enough that you're willing to accept a low real return. However, pursuing long-term goals such as retirement generally requires having some investments with the potential for higher returns, even if they carry a higher degree of risk.

The FDIC insures CDs and bank savings accounts, which generally provide a fixed rate of return, up to \$250,000 per depositor, per insured institution. All investments are subject to risk, including the possible loss of principal. When sold, investments may be worth more or less than the original cost.

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File # 7011983.1