GFC Report

Building Your Wealth & Retirement Income

GFC FINANCIAL MANAGEMENT

2764 Sunset Point Road, Suite 600 • Clearwater, FL 33759
Office: 727-724-9499 • Fax: 727-724-9438
www.gfcfinancial.com

George F. Cerwin, CFP®
President

Working or Looking

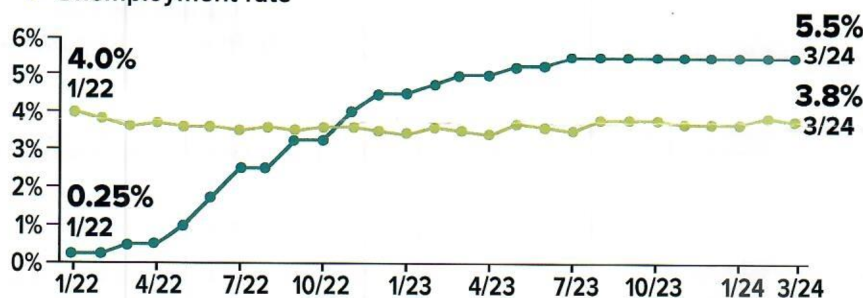
The labor force participation rate — the percentage of civilians age 16 or older who are either working or looking for work — was 62.7% in March 2024, still below the pre-pandemic level of 63.3%. However, the rate for the prime working ages of 25 to 54 was 83.4%, slightly above the pre-pandemic rate of 83.0%.

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

Strong Employment in the Face of Rising Rates

When the Federal Reserve raises interest rates to fight inflation, the unemployment rate typically rises as the economy slows down in response to the higher cost of borrowing. This is the fundamental challenge that the Fed faces in balancing its dual mandate of maintaining price stability while promoting maximum employment.

Remarkably, unemployment remained under 4% during the Fed's unprecedented rate increases in 2022 and 2023, and into early 2024 — the longest period at this level since the late 1960s. Although the inflation battle is not yet won, and higher rates may still impact the job market, this demonstrated extraordinary strength in the American economy.



Sources: Federal Reserve, 2024; U.S. Bureau of Labor Statistics, 2024

PRACTICAL INSIGHTS FOR YOUR FINANCIAL GOALS

A Pension Strategy That May Boost Your Income

If you have a traditional pension — also called a defined benefit plan — when you retire, your plan may offer several payout options, including a qualified joint and survivor annuity (QJSA) if you are married. A QJSA is an annuity that pays a dollar amount (usually monthly) for the rest of your life, with at least 50% of that amount continuing to your spouse after your death.

If your spouse consents in writing, you can waive the QJSA and elect instead to receive a single-life annuity. With this option, payments are made over your lifetime but stop upon your death. Single-life annuity payments are generally significantly higher than QJSA payments, but your spouse would receive no pension benefits after your death.

Life insurance strategy

A strategy called *pension maximization* may offer the best of both worlds. Using this strategy, your spouse waives the QJSA and you elect the single-life option. You and your spouse then use the additional pension income to purchase insurance on your life, with your spouse named as beneficiary. If you die first, the pension payments will stop, but your spouse will receive the life insurance death proceeds free from federal income tax. By coupling the larger pension payments with a life insurance policy, you might increase your total income during retirement, while also providing for your spouse's financial future if you die first.

Questions to ask

Here are some factors to consider before implementing this strategy.

- **Are you insurable?** If not, pension maximization is not a viable strategy.
- **How much will the life insurance cost?** If you are relatively young and in good health, the insurance premiums may be much more affordable than if you are older and/or in poor health.
- **How much more does the single-life annuity pay than the QJSA?** The larger the benefits under the single-life annuity, the more life insurance you may want to buy to replace the income — and the more extra income you may have to pay the premiums. Also factor in any cost-of-living adjustment the pension plan might provide when analyzing your payment options.
- **How healthy are you and your spouse, and what are your life expectancies?** The pension maximization strategy works best if the person receiving the single-life annuity lives a relatively long time, receiving the higher monthly pension payments. On the other hand, the longer your spouse lives after your death, the more valuable the spouse's pension payments under the QJSA option might be.

Tax considerations

Pension benefits are generally treated as taxable income, subject to federal (and possibly state and local) income tax. This is true regardless of whether you elect a single-life annuity payout or a QJSA. However, because the pension benefits are larger with a single-life annuity, electing that option will increase your taxable income during retirement. If you elect the QJSA option, the pension payout to the survivor will be included in the survivor's taxable income.

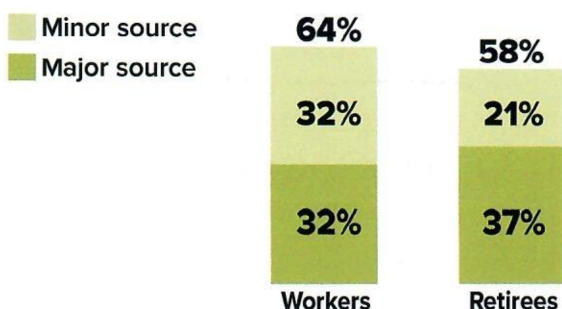
If you use the pension maximization strategy and die before your spouse, the life insurance death benefits will not be included in your surviving spouse's taxable income, because life insurance death benefits generally pass free of income tax to the beneficiary of the policy. Of course, any earnings from investing the life insurance proceeds may be taxable.

Choosing a pension payout option and life insurance coverage can be complex and will impact the financial future of you and your spouse. Be sure to seek qualified professional guidance.

There are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications. Any guarantees associated with payment of death benefits, income options, or rates of return are based on the financial strength and claims-paying ability of the insurer. Policy loans and withdrawals will reduce the policy's cash value and death benefit.

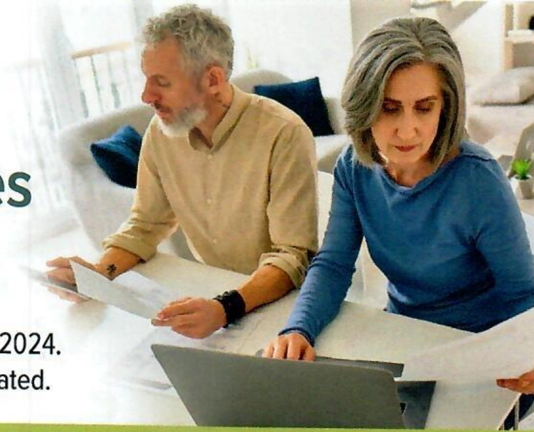
Expecting a Pension?

Although pensions are no longer common in private industry, they have not disappeared, and they remain a mainstay in the public sector. In a 2023 survey, more than half of workers and retirees expected a traditional pension or defined benefit plan to be a source of retirement income.



Source: Employee Benefit Research Institute, 2023

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.

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.

Increase 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 above.)

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 advisor. For more information, see IRS Publication 523 *Selling Your Home*.

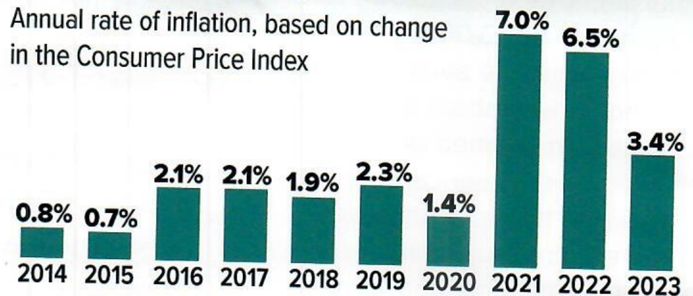
1) U.S. Census Bureau, retrieved from FRED, Federal Reserve Bank of St. Louis, 2024
2) CNN, January 29, 2024

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 — for example, a certain level of retirement income — it's also important to consider the *real return*, which includes the effects of taxes and inflation.

Eroding Purchasing Power

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



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

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. 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.

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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Do you have questions about receiving a pension? Are you considering selling your home? Call us for an appointment today.

Best Regards,

George F. Cerwin, CFP®, CLU is President of GFC Financial Management and has over 45 years of experience working with retirees and those about to retire. George offers Securities and Investment Advisory Services through **Osaic Wealth, Inc.** member FINRA and SIPC. Insurance Services offered through GFC Financial Management, not affiliated with **Osaic Wealth.** Visit our website: www.gfcfinancial.com. Our office address is 2764 Sunset Point Road, #600, Clearwater, FL 33759, and phone number 727-724-9499.