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Fourth Quarter 2013

Guide...Protect...Preserve

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The Best States To Move To For Tax Purposes

Federal income taxes can take a big bite out of your income, but they aren't your only tax concern, particularly if you're about to retire. Don't forget to take state and local income taxes into account. For instance, if you'll be relying less on Social Security and more on investment income during retirement, you might move to a state that doesn't have an income tax or that has relatively low tax rates. Conversely, if you expect to depend heavily on Social Security, consider moving to a state that doesn't tax these benefits. Here are a few key areas to ponder.

State income tax rates: Currently, seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—don't tax income of individuals at all. Two other states—New Hampshire and Tennessee—impose income tax only on dividends and interest. Those favorable taxation rules have made several of these states very popular with retirees.

In addition, some states have a relatively low income tax rate across all income levels. For example, the highest marginal income tax rates for Arizona, New Mexico, Kansas and North Dakota are below 5%. Other states charge a relatively low flat rate regardless of how much you make. These include Pennsylvania (3.07%), Indiana (3.4%), and North Dakota (3.99%). On the other hand, retirees may shy away from notoriously high-tax states such as California (10.55%) and New York (8.97%).

State income tax on retirement income: In the 41 states that do tax income, as well as the District of Columbia, the tax treatment of retirement benefits varies widely. For example, some states don't tax any income from qualified plans such as 401(k)s or Social Security, some states provide a partial exemption, and finally some states tax all retirement income. The two states that currently exempt retirement plan income from taxation are Mississippi and Pennsylvania.

Of course, all of these rules are subject to legislative changes, as revenue-hungry states look for new ways to fill their coffers.

State income tax on Social Security benefits: According to tax publisher CCH, more than one quarter of all states (14) impose income tax on Social Security benefits. The states are Colorado, Connecticut, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, New Mexico, North Dakota, Rhode Island, Utah, Vermont, and West Virginia. These states either tax Social Security income in the same way the federal government does or they provide breaks, usually for taxpayers at lower income thresholds.

State and local sales taxes: 45 states and the District of Columbia impose a state sales-and-use tax. Only Alaska, Delaware, Montana, New Hampshire, and Oregon do not. You may want to consider combined state and local sales taxes when figuring out where to retire. For instance, CCH says

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Rebalancing Plays An Important Role In Producing Returns

The U.S. equity market has more than doubled in value over the past few years. Has your portfolio been rebalanced to take this change into account?

Diversification and asset allocation require periodic rebalancing. That's because 90% of returns are attributable to asset class choices rather than to specific securities.

Let's say your portfolio originally contained 50% U.S. stocks, with the rest split among bonds, real estate, and other alternatives. Between March 2009 and March 2013, the Dow Jones Industrial Average of U.S. stocks rose 129%, following the historic downturn of 2008. If you haven't made any adjustments, the value of the stocks in your portfolio likely has risen well past 50% of the overall value.

It's important to bring that share back down because that increased emphasis on equities has added risk to your portfolio. Stocks eventually will have a down year, and if they make up too great a share of your portfolio your losses could be proportionally higher than what you expect when the market drops.

When it comes to portfolio design, getting the recipe right is more important than the ingredients you choose. We will help you get the right mix of asset classes and ensure that your portfolio is rebalanced regularly to keep that mix intact, while taking into account your risk tolerance, changing situation, and the need to keep investment costs low.

Mary Jane Callaghan & Mitch Glicksman

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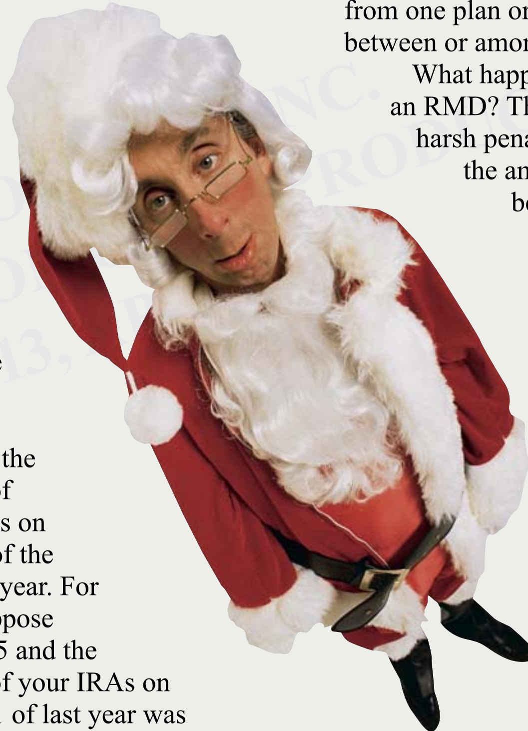
‘Tis The Season To Receive RMDs

When you’re putting together this year’s holiday shopping list, don’t forget to add one gift that you may need to give to yourself: a required minimum distribution (RMD). If you’ve reached age 70½, you’ll have to take an RMD from your 401(k), traditional IRA, or any other retirement plan that lets you shield your contributions from taxes. And the penalty for missing this obligation is a lot worse than getting a lump of coal in your stocking.

The funds that remain in your employer-sponsored retirement plans and IRAs can continue to grow without current investment or income taxes, but you must begin taking RMDs by April 1 in the year after the year in which you turn 70½. Thereafter, you must make the required withdrawal by December 31 of each and every succeeding year. So if you turned 70½ in 2012, you had to take the RMD for the 2012 tax year by April 1, 2013—and now you must withdraw another RMD for the 2013 tax year by December 31, 2013. You’ll pay federal income tax on these distributions, plus you may owe state income tax, too.

There’s an exception for employer-sponsored plans that may apply if you’re still working full-time and you don’t own 5% or more of the company. In that case, you can postpone withdrawals until your retirement. But you’ll still have to take RMDs from your IRAs.

How much do you have to withdraw? First, look up your life expectancy in the special IRS tables. If your spouse is the sole beneficiary for an account, his or her age also may enter into the equation. Distributions are based on the value of all of your accounts on the last day of the previous tax year. For example, suppose you’re age 75 and the value of all of your IRAs on December 31 of last year was $500,000. If your spouse is the sole beneficiary and is less than 10 years younger than you are, the withdrawal factor under the appropriate table is 22.9 Using an online calculator, you can determine that the RMD for the 2013 tax year is $21,834.



Though the IRS requires you to take these withdrawals, if you have multiple 401(k)s or IRAs, it doesn’t care which account the money comes from. You can take the entire amount from one plan or divide up the RMD between or among other accounts.

What happens if you fail to take an RMD? The IRS can impose a harsh penalty equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and any lesser amount that was distributed).

For instance, if you failed to take the RMD in the example above, the penalty would be $10,917. That penalty is in addition to the regular income tax you owe on the RMD.

To be on the safe side, arrange to receive your RMD well before the December 31 deadline. You don’t want to be hit with a hefty penalty if there are any glitches. ●

How To Avoid Bad Surprises In Roth IRAs

If you’ve been tempted to contribute to a Roth IRA, or to convert some or all of the funds in your traditional IRAs into a Roth, it’s likely you’ve been influenced by the lure of future tax-free payouts. However, be aware this tax-favored treatment isn’t automatic, by any means. What’s more, if you’re below a certain age limit, you may be slapped with a tax penalty on top of the regular income tax you’ll owe.

At the same time, though, even if the Roth IRA distributions are subject to tax, the impact may be negligible or nonexistent under special IRS “ordering rules.” That means that even “taxable” Roth distributions may be effectively tax-free.

Here are the basic rules for Roth IRAs. You don’t get any tax break now for contributing to a Roth. But “qualified” distributions from a Roth IRA that has been established for at least five years are 100% exempt from federal income tax. For this purpose, qualified distributions include those made:

- After you reach age 59 ½;
- Because of death or disability; or
- To pay for qualified home buyer expenses (up to a lifetime limit of $10,000).

The rule that often trips people up is the one requiring the Roth IRA to be in existence for at least five years. To compound matters, if you withdraw funds before five years have elapsed and you’re under the magic age of 59 ½, you’ll have to pay a 10% penalty on the distribution amount.

But here’s the silver lining: Under IRS rules, the money you take from a Roth IRA is treated as being distributed in the following order:

1. Roth IRA contributions. That money went in without any tax advantage to you, and you can take it out, for whatever reason, without any penalty or taxes.

2. Contributions made when you

5-Year Results Show Diversification Is Key

The term diversification is used so often in marketing investment products that it's easy to take for granted. Yet it is crucial to investment success and diversifying a portfolio correctly is not so simple.

The accompanying bar chart analyzes segments of the U.S. stock market by divvying up U.S. publicly-held companies based on valuation and market capitalization. Look at how small- and mid-cap companies dramatically outran returns from large-cap companies represented by the Standard and Poor's 500 Growth and S&P 500 Value Index.

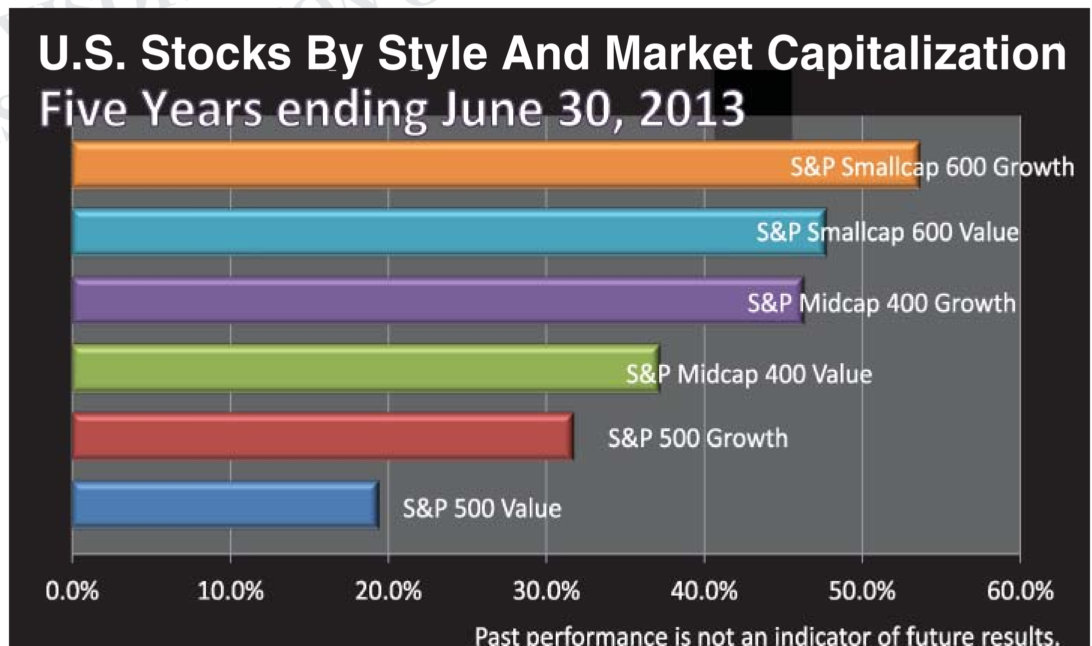
This chart covers the five-year period that ended June 30, 2013, but such differences in performance among different segments of the market are not uncommon. In some five-year periods, large-cap growth companies outperform while small-cap companies or mid-caps might outperform in other five-year periods.

Because no one can reliably predict which market segment will outperform another, it's wise is to avoid making bets on a single segment of the stock market. Put another way, it's wise to diversify. But what exactly does that mean?

Diversification of investments is widely defined as not putting all your eggs in one basket. The egg analogy is something anyone can understand. But diversifying is not as simple as buying a lot of different investments.

To diversify investments, it's prudent to apply the statistical analysis prescribed in the Nobel prize winning academic work that forms the basis of Modern Portfolio Theory, or MPT.

Modern Portfolio Theory Statistics are based on the Capital Asset Pricing Model (CAPM) of expected returns, which Nobel laureate William Sharpe is credited with developing in the early 1960s. CAPM (pronounced CAP –EM) was based on the modern portfolio theory first written about in the 1950s by Sharpe's one-time professor, Harry Markowitz. Markowitz and Sharpe shared the Alfred Nobel Memorial Prize in Economic Sciences in 1990 for their work on MPT.



MPT provides a method for analyzing market trends based on measurable characteristics in portfolios, such as standard deviation, which measures volatility, and R-squared, which measures correlation of one market segment to another.

By applying Modern Portfolio Theory, you are able to rebalance and manage your wealth using an organized system of statistical analysis. You are able to measure correlation coefficients to understand how adding an investment to your portfolio has affected a portfolio like yours in the past. You are able to model the future and how your portfolio might behave through different financial and economic cycles. ●

converted a traditional IRA into Roth status. These may be withdrawn tax-free even if they are part of a nonqualified distribution, but the 10% penalty tax generally applies to withdrawals within five years, unless you're age 59 ½ or older.

3. Contributions made when you converted nontaxable traditional IRA balances into Roth IRA status. Such contributions also may be withdrawn on a tax-free basis subject to the 10% penalty.

4. Earnings within the Roth IRA. These amounts are taxable when withdrawn unless they meet the definition of qualified distributions. In addition, the 10% penalty tax applies to withdrawals made before age 59 ½.

As you can see, federal income tax on a distribution doesn't kick in until you've gone through the first three categories. For many people with a sizable amount in a Roth, distributions won't be taxable at all, even if funds are withdrawn within five years of setting up the account. ●

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Managing Your Tax Bracket Now Crucial

Four tax law changes that took effect in 2013 are driving high-income earners to manage their tax brackets more carefully.

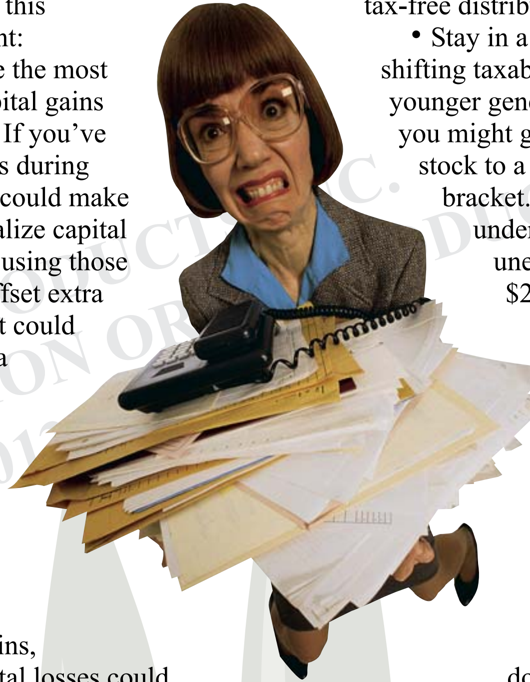
1. A new top income tax rate for ordinary income of 39.6% (previously 35%) has been added for single filers with taxable income above $400,000 and joint filers above $450,000.

2. For investors who exceed those same thresholds, the maximum tax rate on long-term capital gain has increased from 15% to 20%.

3. A new 3.8% surtax applies to the lesser of "net investment income" (NII) or the amount by which modified adjusted gross income exceeds $200,000 for single filers and $250,000 for joint filers. The definition of NII includes capital gains and dividends, but not payouts from retirement plans and IRAs.

4. The tax benefits available for itemized deductions and personal exemptions are phased out for taxpayers above certain income limits.

Faced with this changing tax landscape, you need to be especially vigilant to keep "bracket creep" in check. At the same time, it could make sense to realize year-end income up to the next bracket threshold. Here are several tax strategies to consider in this environment:



- Make the most of your capital gains and losses. If you've taken losses during the year, it could make sense to realize capital gains now, using those losses to offset extra income that could put you in a higher bracket or subject you to the 3.8% surtax. Or, if you have existing gains, taking capital losses could offset them and up to $3,000 of ordinary income.
- Convert a traditional IRA to a Roth IRA—but stagger the amount you convert each year to avoid rising into a higher tax bracket. The converted amount is taxable as ordinary income, but it may pay off in the form of future tax-free distributions.
- Stay in a lower bracket by shifting taxable income to the younger generation. For instance, you might give dividend-paying stock to a child in a low tax bracket. Just keep in mind that under the "kiddie tax," unearned income above $2,000 received by a dependent child in 2013 generally will be taxed at your top rate.
- Reduce your taxable income by making charitable gifts. The tax law generally allows you to deduct the fair market value of donated property that you've held for more than a year. However, deductions for charitable gifts are among those that may be reduced for upper-income taxpayers.

Best States To Move To

(Continued from page 1)

that Tennessee (9.44%), Arizona (9.16%), Louisiana (8.87%), Washington (8.86%) and Oklahoma (8.67%) have the highest combined state and local sales tax rates. Among states with sales taxes, the lowest combined rates are in Alaska (1.11%), Hawaii (4.35%), Maine (5%), Virginia (5%), and Wyoming (5.17%).

State and local property taxes: While property values have declined over recent years in many areas, property taxes haven't necessarily gone down, too. According to the Tax Foundation, residents of New York, New Jersey, and Connecticut had the highest tax burdens in 2010. In those states, residents forked over more than 12% of income in state and local taxes.

Residents of Alaska, which has been the least-taxed state for more than a quarter of a century, paid the lowest percentage of income in 2010 at 7%, followed by South Dakota, Tennessee, and Louisiana.

State estate taxes: Estate taxes also may influence where you want to retire. The rules can differ widely from state to state and in several cases, state laws don't follow federal estate tax rules. As of January 1, 2013, 17 states and the District of Columbia collected estate tax and had varying exemption thresholds. (Some other states have inheritance taxes.) In several states, the threshold is $1 million or less. Only Delaware, Hawaii, and North Carolina use the current federal exclusion amount of $5 million (indexed to $5.25 million in 2013). Certain other states have neither an estate tax nor an inheritance tax. But these rules, too, are subject to change.

Remember that this is just a brief summary of state taxation rules. Of course, other factors also will come into play, but it pays to consider state and local tax consequences in choosing a location for your retirement years. ●

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