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Guide...Protect...Preserve

Learn The Ins And Outs Of Education Tax Breaks

If you have one or more children in college, or your offspring will be heading to college or university soon, you already know about the ever-rising cost of higher education. It's not unusual for a year at an elite university to cost $50,000 or even more. Suppose you have three children who have the grades to get into top-notch colleges and each one spends four years at such a school. That's a total cost of at least $600,000!

Although federal tax laws provide some relief to parents in the form of two higher education credits and a tuition deduction, those tax breaks are phased out for upper-income taxpayers. What's more, you can claim only one of those tax benefits in a year. Here's what's available:

1. American Opportunity Tax Credit (AOTC). The AOTC, formerly known as the Hope Scholarship credit, recently was extended by Congress through 2017. The credit equals the sum of 100% of the first $2,000 of qualified tuition and related expenses and 25% of the next $2,000 of such expenses, for a maximum annual credit of $2,500. But you could claim the credit for each child who's in college, so if you have three kids in school at the same time, you could claim a maximum credit of $7,500 in that year.

Under another recent tax law change, the AOTC now applies to the first four years of a student's higher education. Previously, it was limited to just two years. Furthermore, you're allowed to receive up to 40% of the value of the AOTC as a tax refund, up to a maximum of $1,000, in the unlikely event that you have zero tax liability.

But the AOTC is phased out based on a family's modified adjusted gross income (MAGI). For 2015, the phaseout range is between $80,000 to $90,000 of MAGI for single filers and $160,000 to $180,000 for joint filers. Once you exceed the higher threshold, you can't claim the AOTC at all.

2. Lifetime Learning Credit (LLC). Unlike the AOTC, the LLC is on the books permanently, but it is generally not as beneficial as its close cousin. It is equal to 20% of the first $10,000 of qualified expenses, for a maximum of $2,000. And that limit applies to each taxpayer, not each student. So for those parents with three children in school at the same time, the maximum credit remains $2,000. What's more, unlike the AOTC , the LLC can't result in a tax refund.

Finally, the MAGI phaseout levels for the LLC are even lower than they are for the AOTC. For 2015, the range is between $55,000 to $65,000 for single filers and $110,000 to $130,000 for joint filers.

3. Tuition deduction. Finally, you may be able to deduct tuition and related fees that you pay to a college on behalf of your dependent children. The allowable deduction is either $4,000 or $2,000 depending on your MAGI for the year. For single filers, the deduction is $4,000 for a MAGI of up to $65,000 and $2,000 if your MAGI is between $65,000 and $80,000. Joint filers can deduct $4,000 for a MAGI of up to $130,000 and $2,000 if your MAGI is between $130,000 and $160,000. Exceed those upper thresholds and you don't get the deduction.

The tuition deduction officially expired after 2013. However, after much debate in Congress, it was extended

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Warren Buffet Gives Sage Advice But You Must Really Listen

Warren Buffett, the billionaire CEO of Berkshire Hathaway, is known as an investment guru, and there are plenty of people and websites dedicated to following his every move and trying to replicate each one. When Buffett decided it was time to buy a car dealership, other high rollers decided to buy car dealerships. He wields that kind of influence.

Admittedly, Buffett is brilliant, yet he often dispenses homespun advice that shows common sense can lead to more dollars and cents. Here are just a few of his pearls of wisdom:

"Rule No. 1: Never lose money. Rule No. 2: Don't forget rule No. 1."

"You don't need to be a rocket scientist. Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ."

"When we own portions of outstanding businesses with outstanding managements, our favorite holding period is forever."

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price."

"Time is the friend of the wonderful business, the enemy of the mediocre."

"I try to buy stock in businesses that are so wonderful that an idiot can run them, because sooner or later one will."

Maybe you can take a page out of Warren Buffet's book without risking a small fortune. Invest for the long term and don't fall into the trap of market timing.

Mary Jane Callaghan & Mitch Glicksman

FBAR Penalty Can Run Into Millions

No matter how old you are, the IRS isn't likely to show you any mercy, especially if you're trying to hide funds in offshore accounts without paying the required taxes. This has been demonstrated, in dramatic fashion, in a case involving an 87-year-old retiree who earned a fortune as a specialty-glass importer. Carl Zwerner, who lives in Florida, has been hit with penalties equaling 150% of the value of his foreign bank account, for a staggering total of $2.24 million.

Over the past decade, the IRS has ramped up its efforts to uncover tax cheats who are stashing cash in foreign accounts that were protected previously by privacy laws. Significantly, U.S. taxpayers are required to file a Report of Foreign Bank and Financial Accounts (FBAR). The penalty for failing to file the FBAR can equal 50% of the value of the unreported assets.

The IRS has joined forces with the Justice Department in using this weapon to ferret out tax cheats. Dozens of high-profile cases during the past few years have resulted in fines reaching into the millions.

The threat of paying excessive penalties has driven some tax evaders into an IRS-sponsored amnesty program. Under the program, taxpayers must fork over back taxes, fines, and penalties, in addition to providing information to the IRS about their foreign accounts. Since the program was authorized in 2009, more than 43,000 taxpayers have paid about $6 billion into government coffers.

Zwerner was a unique case. He said he didn't know he had to file FBARs for his account at ABN Amro Group N.V., one of the Netherlands' largest banks, until 2008. At that time, he couldn't enter the amnesty program due to income limits, so he amended his 2008 return. The IRS went after him for failing to file FBARs for four years—from 2004 through 2007—and sought the 50% penalty for each year. The jury in his trial handed down a verdict for the first three years.

For 2004, Zwerner's account was valued at $1.48 million; $1.49 million for 2005; and $1.55 million for 2006. The FBAR penalties assessed were $723,762, $745,209, and $772,838, respectively, adding up to a total of $2.24 million.

In another publicized recent case, H. Ty Warner, the billionaire founder of the Beanie Babies toy empire, pleaded guilty to evading taxes on assets of up to $107 million hidden in Swiss bank accounts. Warner ended up paying an FBAR penalty of $53.6 million.

The message is clear: The IRS will show no quarter. However, at least the income limits that barred Zwerner and others from entering the amnesty program have been removed, giving some wealthy U.S. taxpayers another option. ●

Franchise Costs Range From $10,000 To $14.6 Million

Franchises are a lot like wine and people: They come in all price ranges and sizes. For example, a Choice Hotel International franchise is reputedly the world's most expensive, at $14.6 million. On the other hand, you can buy a Win Home Inspection or a Cruise Planner (American Express Travel) franchise for a mere $10,000. Those are two of the cheapest.

Some other very expensive franchises include Amazing Spaces (storage units), for $8.25 million; Golden Corral for $6.76 million, KFC for $2.5 million, and Hardee's for $1.6 million. At the other end of the cost spectrum are Tru Blue Total House Care ($20,000), Good Feet ($75,000), Sport Clips Haircuts ($100,000), and Yum Yo's Frozen Yogurt ($150,000). The cost of owning a McDonald's franchise depends on a number of considerations.

For 35 years, Entrepreneur Magazine has published its own top 10 list of franchises. The magazine's honor roll (with price ranges) for 2014 includes:

1. **Anytime Fitness, $56,290 - $353,890**
2. **Hampton Hotels, $3.69 million - $6.57 million**
3. **Subway, $85,690 - $262,850**
4. **Supercuts, $113,750 - $233,600**
5. **Jimmy John's Gourmet Sandwiches, $330,500 - $519,500.**
6. **7-Eleven Inc., $50,000 - $1.63 million**
7. **Servpro, $138,550 - $187,190**
8. **Denny's Inc., $1.12 million - $2.61 million**
9. **Pizza Hut Inc., $297,000 - $2.1 million**
10. **Dunkin' Donuts, $294,000 - $1.51 million**

Entrepreneur's selection process for the 2014 list began with a survey in July 2013. Of the 853 companies that survived a first round of culling, the top

Live Long And Prosper: Roll Out A Stretch IRA

The individual retirement account (IRA) is a time-tested way to save for retirement. Typically, you make contributions to an IRA during your working career, or you roll over funds to an IRA from a 401(k) or another employer plan, or both. You might end up with a sizable stash from which you'll be able to withdraw during retirement.

But you may not have to tap that part of your nest egg much if you can rely upon retirement income from other sources, though you will have to take required minimum distributions (RMDs). If it looks as if much of the account will survive you, you might consider the potential benefits of a "stretch IRA." That can help an IRA be there for your chosen beneficiaries long after you're gone.

Under the rules for IRAs, you can take as much as you want out of your account whenever you want, although there's normally a 10% tax penalty on distributions you take before you reach the age of 59½. At the same time, though, you can leave money in the IRA indefinitely, except for taking the RMDs that must begin when you hit age 70½. Those are taxed as ordinary income, which means the tax rate on that money may be as high as 39.6%. And there can be other tax consequences, too.

The idea behind the RMD rules is to force you to use, and pay tax on, the funds that have been accumulating in the account without being touched by taxes. The amount of your annual RMD normally will be based on your account balance on December 31 of the prior year, with that amount divided by your life expectancy according to an IRS table. For example, a 75-year-old with $500,000 in IRA assets would use a factor of 22.9 from the universal life expectancy table to get an RMD of $21,834 for the current tax year.

This system is designed to exhaust the account if you live long enough. But there's an alternative that could reduce the size of the RMDs. If you designate your spouse as the IRA's sole beneficiary, and if your spouse is more than 10 years younger than you, RMDs can be based on your joint life expectancy. Assuming our 75-year old owner with $500,00 in IRA assets has a 60-year-old spouse, their joint life expectancy would be 26.5, resulting in an RMD for the year of $18,868.

The basic concept behind the stretch IRA is to postpone withdrawals as long as possible and to minimize RMDs both before and after your death. The following steps could help you get there:

- Make sure you have properly established beneficiaries, both primary and secondary, for all of your IRAs. Double-check your paperwork.
- Limit your RMDs to the amount you're required to withdraw. Withdrawing the bare minimum allows you to preserve a larger nest egg.
- When you die, your beneficiaries who inherit what's left of your account can arrange payouts based on their life expectancies. If they're younger than you were, the RMDs will be smaller.
- If you have multiple beneficiaries, each one should establish a separate account for his or her inherited IRA assets. RMDs have to begin in the year following the year of death. Without separate accounts, RMDs will be based on the life expectancy of the oldest beneficiary. Dividing your account will reduce the RMDs for younger beneficiaries.
- Name successor beneficiaries. This ensures that RMDs will be withdrawn over your beneficiaries' entire life expectancies, even if they don't live that long. Otherwise, a beneficiary's estate might have to pay out the entire amount.

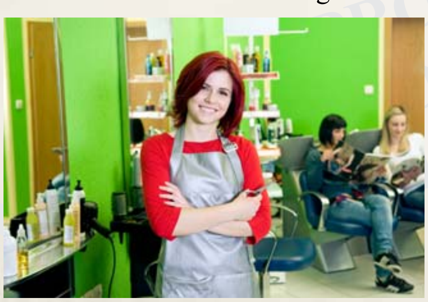
Timing can be crucial in establishing a stretch IRA. To qualify for the benefits, your beneficiaries must establish accounts in your name by December 31 of the year after the year of your death. That leaves some time for making decisions about inherited IRA funds, but it's important not to dilly-dally.

It's also essential for your heirs to follow the rules on RMDs. The tax penalty for failing to take one, whether you're the original IRA owner or a beneficiary of an inherited account, is equal to 50% of the required amount (less any amount that actually was withdrawn). Returning to our example of a 75-year-old IRA owner with $500,000 of assets, failing to take the RMD this year could result in a penalty as high as $10,917 (half of $21,834). And that's on top of regular income tax.

Note that lifetime RMDs aren't mandatory for Roth IRA owners. And while beneficiaries who inherit a Roth must take RMDs based on their life expectancies, those distributions generally aren't taxable. ●

500 made the magazine's Franchise 500® ranking, based on financial and statistical data from July 2011 through July 2013.

All companies, regardless of size, are judged by the same criteria: objective, quantifiable measures of a franchise operation. The most important factors include financial strength and stability, growth rate, and size of the system.



The magazine also considers the number of years a company has been in business and the length of time it has been franchising, startup costs, litigation, percentage of franchise terminations, and whether the franchising company provides financing. An independent CPA analyzes financial data. Subjective elements such as franchisee satisfaction or management style are not included in the analysis. The objective factors are plugged into a special formula, with each eligible company receiving a cumulative score. The 500 franchises with the highest cumulative scores become the magazine's Franchise 500®. ●

What's The Step-Up In Basis Worth?

When you're developing an estate plan for your family, several elements factor into the equation, including a lot of tax ramifications—which may include both estate taxes and income taxes. They're not mutually exclusive and, in fact, they're often intertwined.

A case in point is the so-called "step-up in basis" on inherited assets. That can be a reason to keep some assets in your estate rather than trying to reduce the estate's value.

Slimming down an estate, particularly by making gifts to family members during your lifetime, is often a good idea. However, there's a marital deduction that normally allows you to leave unlimited assets to your spouse free of estate tax, while transfers to other heirs are sheltered by a generous individual estate tax exemption that's inflation-indexed. Each person can shield $5.43 million from estate and gift taxes in 2015, up from $5.34 million in 2014.

Meanwhile, if you sell real estate or other assets before you die, you'll owe capital gains tax on your profits. The maximum tax rate on a long-term gain (on assets you've held longer than a year) is 15%, or 20% for investors in the top ordinary income tax bracket. In addition, you may be liable for a 3.8% surtax on net investment income (NII), including capital gains, that exceeds an annual threshold. That adds up to a possible effective tax rate of 23.8% on capital gains at the federal level.

But if you bequeath appreciated assets to your heirs, they can largely avoid capital gains taxes. Those taxes are calculated according to how much the price has gone up from your "basis" in the asset—basically what you paid for it, subject to adjustment. When you die, the basis of the assets your heirs receive is "stepped up"—increased to their value on the date of your death. That eliminates tax liability on the appreciation of the assets during the time you owned them. Of course, those assets have to be in your estate to qualify for that benefit, but the generous exemptions for estates will help your heirs avoid estate taxes, too.

Consider this example. Tom, a resident of Florida, bought an apartment building for $900,000 that is currently worth $2.2 million. If Tom sells the building now, he must pay an effective tax rate of 23.8% on a $1.3 million capital gain, or $309,400 (23.8% of $1.3 million). But what if he keeps the property and leaves it to his heirs? The basis of the property is stepped up to the full $2.2 million, and they'll owe capital gains taxes only if it appreciates further before they sell it. What's more, the estate tax exemption means they won't owe estate taxes on their inheritance.

Note that Florida doesn't have a state income tax. If Tom resided in a high tax state, such as California or New York, the savings would be even more pronounced. ●

Education Tax Breaks

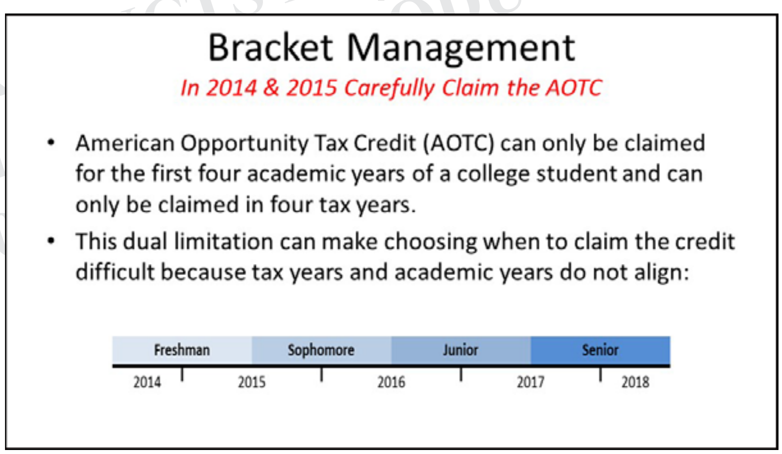
(Continued from page 1)

retroactively fone year or 2014.

Remember that you can claim only one of these three tax breaks in a given year, even if you don't exceed the phaseout limits. Because those cutoffs are relatively low, and because the tax relief they offer won't make much of a dent in the overall cost of sending a child to college, most parents will need to look elsewhere for tax benefits. Consider the advantages of college saving devices such as Section 529 plans and Coverdell Education Savings Accounts (CESAs).

Section 529 plans can prove to be especially valuable because they have very high contribution limits and the money you contribute to a plan is invested and can compound over time. You aren't taxed on investment earnings in a plan and distributions for most college expenses also aren't taxed. And if there's money left over after one child finishes school, you can transfer the account to a sibling.

CESAs aren't as attractive as 529 plans because CESAs have an annual contribution limit of $2,000, although if you begin putting in money when a child is very young it could add up to a decent amount of education savings, and the assets in these accounts also can grow without any current tax. Moreover, a CESA can be tapped to pay for private school education before a child enters college. That's not allowed with Section 529 plans. ●



Evergreen Financial Associates, LLC • www.efallc.com
Mitch Glicksman • 8180 North Hayden Road, Suite D203, Scottsdale, AZ 85258 • Toll Free: 888.865.4449 • Phone: 480.951.6536 • Fax: 480.922.3007
Mary Jane Callaghan • 300 C Lake Street, Ramsey, NJ 07446 • Phone: 201.934.1818 • Fax: 201.934.4040