Oklahoma City downtown Monthly

BE TAX-SAVVY ABOUT COMPANY STOCK
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Recently, we have consulted with several individuals regarding how to best handle company stock in their retirement plans. (Think Kerr-McGee) Most folks in this situation come to us "dead set" on rolling their retirement plan assets into an IRA. This is often the best strategy, but not always.

A little-publicized IRS rule could result in big tax savings. Called the Net Unrealized Appreciation Rule (NUA), it's been around for over 60 years, yet few people seem to be aware of its existence. The correct application of this rule, in the appropriate case, can mean huge tax savings.

IRA Rollover vs. NUA
The advantage of an IRA Rollover is that no tax is due upon rollover and the funds continue to enjoy tax-deferral. All withdrawals, however, are subject to ordinary income tax. With the NUA strategy, the main advantage is that you can trade ordinary tax rates for more favorable capital gains rates and can also avoid the required minimum distribution requirements applicable to IRAs. The drawback of NUA is that you must pay ordinary tax (but only on the cost basis of the company stock), upon distribution from the plan.

How is NUA Taxed?
Think of three separate, taxable "blocks" at play in the NUA strategy. The first is the cost basis, which is taxed at ordinary income rates at the date of distribution. The next block, the NUA itself, is the difference between the cost basis and the market value at the date of distribution (defined at the distribution date, but not actually taxed until the eventual sale.) NUA is always taxed at the long-term capital gains rate – no matter when the company stock is sold. Finally, there's the additional appreciation (if any) of the company stock that occurs between the distribution and the sale. This block is taxed at either short-term or long-term capital gains rates, depending on how long it's held.

> The hardest thing in the world to understand is the income tax.
> **Albert Einstein**

Again, the big advantage is that NUA is always taxed at long term capital gains rates, which can mean huge savings. For instance, today the top federal income tax rate is 35% vs. a 15% long term capital gains rate – a savings of over 50%!

Tax treatment is determined by how assets are distributed from the plan. To qualify, company stock must be removed from the plan in the form of an in-kind, lump sum distribution. But NUA is not an all or nothing strategy – you can elect it on some of the company stock and roll over the rest of the assets to an IRA. However, any company stock that is rolled to an IRA loses NUA availability forever.

NUA Summary

The NUA strategy is not for everyone, but it can be very helpful under the right circumstances. The larger the unrealized gain in the company stock and the higher your tax bracket, the greater the potential benefit. If you are over-weighted with employer stock, you might consider the NUA election for just a portion of the distribution, rolling over the balance into an IRA. The tax savings may be less, but the rolled-over shares can be sold to more effectively diversify the portfolio. The strategy is also available to beneficiaries for employer stock held in a qualified plan that has not been distributed before death.

Consider the pros and cons before making your choice – and above all seek qualified counsel to get the job done right.

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