



A tax-advantaged NUA-nce

Keeping with the acronym theme this month, if you have highly appreciated company stock in your 401k, one worthy of keeping in your memory bank is “NUA.” This stands for net unrealized appreciation, and it can be a source of significant tax savings.

Here’s an example:

After 35 years at GoodCo, Mary is retiring. She has been a diligent saver and contributed to her company’s 401k plan for as long as she was eligible. Mary has a diversified portfolio of mutual funds worth \$1 million as well as \$250,000 of GoodCo stock in her 401k. The cost (basis) of her GoodCo stock is \$50,000, meaning it has performed very well over the years.

Before Mary rolls over her 401k into an IRA, she can elect to do an NUA transaction for the company stock portion. These shares will transfer into a new after-tax investment account and retain their original cost basis.

Here is where the tax implications come into play:

Mary will owe taxes – at ordinary income tax rates – but only on the cost basis in her company stock at the time she does the NUA transaction. Mary is in the 28% tax bracket, so this will create \$14,000 of taxes. But any subsequent sales of GoodCo stock are taxable at the 15% long-term capital gains rate. So if Mary sold all her stock next year, she would incur taxes of \$30,000.

If Mary did not elect an NUA and rolled her entire account to an IRA, any money she withdraws is taxable at ordinary income rates. If Mary wants to take out \$250,000 from her IRA (the amount she had in GoodCo stock), then she will incur taxes of \$70,000, assuming she is still in the 28% tax bracket. By not doing an NUA, Mary incurred \$26,000 of taxes that she could have avoided!

The time to consider an NUA transaction is before you roll over your 401k to an IRA. Once you have completed a rollover, the tax benefits of an NUA transaction are lost forever. If you have a significant chunk of company stock in your 401k and you’re closing in on retirement or a job change, we can help reduce your future tax bill.

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