

Strategies for Retirement Plan Distributions of Company Stock

Critical Choices

Have you recently changed jobs or are you planning to retire in the near future? If so, you'll likely have to make some critical choices about the money in your retirement plan. For many people, the most appropriate option is to roll the money directly into an IRA.

However, if a portion of your plan assets are held in highly appreciated company stock, it may be advantageous from a tax standpoint to take a taxable, in-kind (stock in certificate form) distribution of the company stock shares, and roll the remaining non-stock assets into an IRA. That way, you can take advantage of special tax treatment under the net unrealized appreciation (NUA) rule.

Understanding the NUA Rule

The NUA rule refers to the special tax treatment of company stock that is distributed from qualified plans, such as 401(k)s. With this rule, you will immediately be taxed at ordinary income rates on the cost basis of the stock—not the current market value.

If the price of the stock has appreciated considerably, this could be a significant advantage when the stock is eventually sold, since the net unrealized appreciation (the difference between the cost basis and the current market value at time of

distribution) generally qualifies for the maximum 15% long-term capital gains rate.¹ If the same company stock is rolled over into an IRA, the taxable distribution from the IRA would be taxed at ordinary income tax rates, which could be 28% or more.

For example, a share of stock purchased at \$10 (the cost basis) may now be worth \$25—meaning \$15 is net unrealized appreciation. You can generally qualify for capital gains tax treatment (not ordinary income tax rates which can be much higher) on this net unrealized appreciation at a later date when you sell the securities.

The NUA Rule in Action

To get a better understanding of the NUA rule, consider this hypothetical example. Katharine purchases 1,000 shares of company stock within her retirement plan, at a cost of \$20 per share. When she leaves the company, the stock is trading at \$50 a share.

Therefore:

- The total value of the stock is \$50,000 (1,000 x \$50 a share).
- Her cost basis is \$20,000 (1,000 x \$20 a share).
- The NUA is \$30 a share (\$50 minus \$20 a share), or a total of \$30,000.

Pay Attention to the Fine Print

While the NUA rule can lower one's tax bill, it's critical to follow its regulations carefully:

- > The distribution of the stock must generally be as a lump sum, not a partial distribution.
- > The stock must be distributed in-kind (certificate form). The NUA rule doesn't apply if the stock is liquidated and taken in cash.
- > The NUA rule doesn't apply if you roll the company stock into an IRA. If you have already rolled the stock into an IRA, the ability to apply the NUA rule is generally lost.
- > If you are under age 59½, a 10% early withdrawal penalty may apply to the in-kind stock distribution.

1. Any additional gains after the distribution are subject to the short term capital gains rate if the sale is made within one year of the distribution.



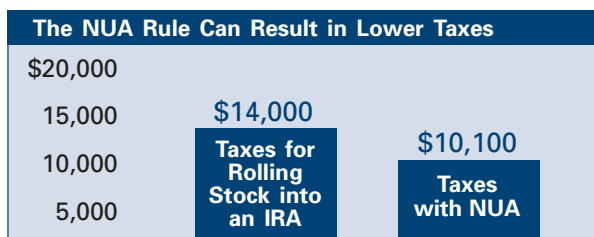
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Individual Retirement Answers

- > **Roll the Stock into an IRA**—If Katharine were to roll the stock into an IRA and later withdraw it, the entire \$50,000 would be taxed at her ordinary income rate. If her rate is 28%, Katharine would incur a total tax bill of \$14,000.
- > **Lump Sum Distribution In-kind**—On the other hand, if Katharine takes a lump-sum distribution of the stock in-kind (in certificate form), she would immediately have to pay the 28% ordinary income tax on the \$20,000 cost basis. In this case \$5,600.²

However, assuming a 15% capital gains tax, the NUA bill would be \$4,500. The end result, the total tax bill would be \$10,100 or \$3,900 less than if Katharine had rolled the stock into an IRA.



This example is hypothetical and not an indication of any actual investment.

Is an NUA Strategy Right for You?

While the tax savings under the NUA rule are compelling, the strategy may not be appropriate for everyone. Consider the following:

- > **Highly Appreciated Stock**—The major benefit of the NUA rule is the preferential tax treatment of the appreciated portion of the stock. If the stock has not appreciated greatly the net tax benefit may be marginal.
- > **Current Tax Liability**—Utilizing an NUA strategy will generate an immediate tax bill on the stock portion of your distribution. While

the total bill may be lower than the rollover option, if you cannot afford the tax liability it may not be a viable option. Keep in mind utilizing an NUA strategy may also cause you to move into a higher tax bracket.

- > **High Tax Brackets**—If you're in a high tax bracket, the difference between your ordinary income rate and the capital gains rate is greater than if you were in a lower tax bracket. As such, the NUA rule benefit may be greater for those people in a higher tax bracket.
- > **Alternative Minimum Tax**—When you eventually sell your company stock in the taxable account, you may generate a large enough capital gain to trigger the Alternative Minimum Tax. If so, you may want to see if selling the stock in installments over a period of years may be more beneficial. Please see your tax advisor for more details.
- > **Portfolio Diversification**—If you already maintain a diversified retirement portfolio, an NUA strategy may be appropriate. However, if your retirement assets are mostly in company stock, you may be better served by either rolling over the shares into an IRA and selling a portion within the IRA, or selling a portion of the shares within the employer's plan and rolling over the cash into an IRA. In either case, you can use the proceeds of the sale to diversify your portfolio.

Customized Solutions

As you've seen, an NUA strategy can be highly beneficial for certain investors. To learn whether it is a suitable option given your situation, you should consult with your financial professional and tax advisor.

In developing a strategy for your retirement plan, your financial professional can access the resources of The Rollover Consulting Group—an experienced group of retirement consultants who understand the nuances of retirement planning. With guidance from your financial professional and The Rollover Consulting Group, you have the opportunity to maximize your retirement savings. The Rollover Consulting Group's services are provided by New York Life Investment Management LLC, a wholly owned subsidiary of New York Life Insurance Company.

2. Dividends may be taxable if the stock is not rolled to an IRA.

New York Life Insurance Company and New York Life Investment Management LLC and its affiliates do not provide tax and/or legal advice. Please consult with your professional tax advisor for information regarding your personal situation.