

Do you have thousands of dollars in company stock?

If so, there's a way you may be able to pay less in taxes upon distribution of your retirement plan account.

If you've accumulated a significant amount of company stock in your qualified retirement plan and if that stock has grown dramatically over time, then you may want to take advantage of favorable tax treatment under the net unrealized appreciation (NUA) rule.

NUA is the difference between the price at which the plan bought the company stock (called the "cost basis") and the stock's current price. For example, if the plan bought a stock share for \$10 and it grew to \$60, the NUA would be \$50 (and would be reported in Box 6 of Form 1099R).

Under the NUA rule, when you request a distribution of your account as a lump sum with an in-kind distribution of your stock, only the cost basis is subject to income tax (and potentially an early withdrawal penalty) – not the stock appreciation (NUA). The NUA is not subject to tax until the company stock is sold, and it will never be subject to an early withdrawal penalty. At that time, the taxes assessed will be at capital gains rates and not at ordinary income tax rates, which can be much higher.

If you choose not to take advantage of the NUA rule, you can take a distribution of the entire amount and subsequently pay income taxes on the entire distribution. Or you can roll the stock into an IRA and defer taxes until distribution (however, when you withdraw your stock from the IRA, the entire amount will be taxed at ordinary income tax rates).

Impact on your taxes

To take advantage of the NUA rule, the company stock must be distributed in certificate form. It's important to realize that by distributing your company stock in this manner, you must immediately pay income taxes on the stock's cost basis. However, you only pay capital gains taxes on the NUA when you sell the stock certificates (which you may hold indefinitely). The NUA rule can result in considerable tax savings. See how in the example on the next page.

Both Investor A and Investor B have 5,000 shares of company stock that the plan purchased at \$10 a share. Twenty years later, the company stock is now selling at \$60 so the total market value of their stock is \$300,000. Therefore, the total NUA on the stock is \$50 per share for a total of \$250,000. However, Investor A and Investor B decide to distribute their money in different ways. As you can see, it has a significant impact on their money. (Example assumes a 35% tax rate).

	Taxes	Total after distribution
Investor A liquidates stock and withdraws it as cash.	$\$300,000$ (market value) $\times 35\%$ (income tax) <hr/> $\\$105,000$ (total taxes paid)	\$195,000
Investor B takes a lump-sum stock distribution in certificate form (NUA).	$\$50,000$ (cost basis) $\times 35\%$ (income tax) <hr/> $\\$17,500$	
	$\$250,000$ (total NUA) $\times 15\%$ (capital gains tax) <hr/> $\$37,500$ on NUA when stock is sold <hr/> $\\$55,000$ (total taxes paid)	\$245,000

Questions?

This is a complicated tax rule, so you probably have questions. Be sure to contact a tax or legal advisor for guidance on your particular situation.

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