

Net Unrealized Appreciation (NUA)

A strategy for highly appreciated company stock in a qualified plan



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Financial.Planning@lpl.com

WHAT IS NUA?

An option to transfer appreciated company stock from a qualified plan to a brokerage account in-kind. The basis would be taxed at distribution with the rest taxed at capital gains rates as it is sold. The “net unrealized appreciation” is the difference between the company stock price and basis (which is the source of the potential tax benefit). *IRC §402(e)(4)*

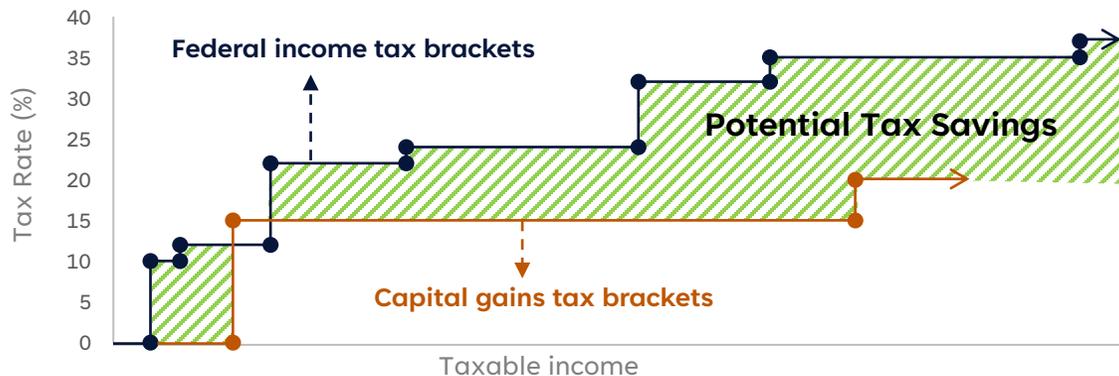
BENEFITS OF NUA:

- Long-term capital gains tax on the gain vs. ordinary income from IRA distributions
- The ability to control when the stock is sold vs. having RMDs from an IRA
- Can gift appreciated company stock to charity or heirs

THE PROCESS:

- Contact the plan administrator to request cost basis information and required paperwork
- When processed, the company stock is usually sent to a transfer agent and then transferred to the client's brokerage account in-kind (not sold or liquidated)
- The plan administrator will usually report the NUA amount on IRS form 1099-R, Box 6

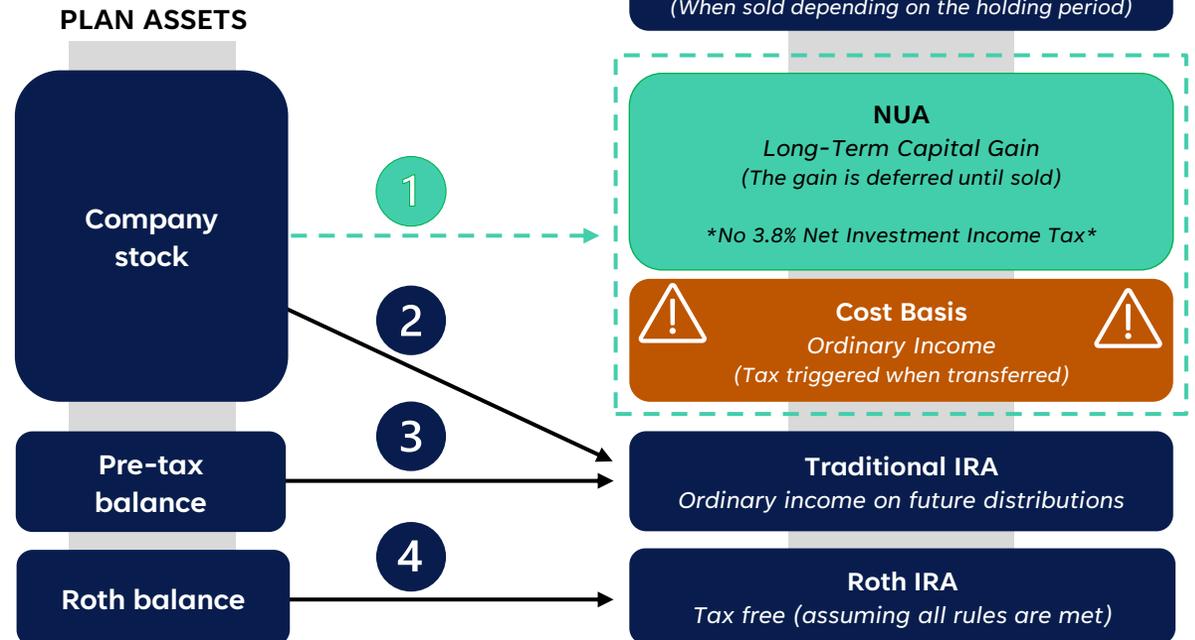
WOULD NUA BE FAVORABLE FROM A TAX PERSPECTIVE?



OVERVIEW:

- 1: Shares chosen for NUA are transferred in-kind to a brokerage account (tax **IS** triggered)
- 2: Shares not used for NUA are sold and the balance is rolled over to an IRA (no tax triggered)
- 3: All pre-tax assets in the plan are rolled over to an IRA (no tax triggered)
- 4: All Roth assets in the plan are rolled over to a Roth IRA (no tax triggered)

TAX OUTCOMES AFTER ROLLOVER



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Important rules and triggering events



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IMPORTANT RULES:

- The employer stock must be distributed in-kind to a brokerage account.
 - Must be true employer stock. Company stock funds are acceptable if the fund only holds cash and can be converted to company shares (which are then transferred in-kind).
 - If the entire qualified plan balance is transferred to an IRA or a different qualified plan (including the company stock), the opportunity for NUA is lost.
- Once NUA is processed, the entire qualified plan balance must be distributed in a single tax year. The total account rollover must also occur after a triggering event (*see below*).
- The basis of the NUA shares is taxed as ordinary income when processed. If the client is younger than 59.5, the 10% early withdrawal penalty may apply.

Note: If the separation from service trigger is available and the client is between the ages of 55 and 59.5 when they separate, there could be an exception to the 10% penalty (Age 55 Rule).
- Regarding the gain on NUA shares:
 - It will always be taxed at long-term capital gain rates (no matter how long the stock was owned inside of the qualified plan).
 - Not** eligible for a step-up in cost basis at death (IRS Revenue Ruling 75-125). The inherited stock will receive an adjustment to basis of FMV at date-of-death less any unrecognized NUA gain.
 - Not** subject to the 3.8% Net Investment Income Tax (Medicare surcharge tax) when the shares are sold in the future.
 - Recommendation:** Given the various rules outlined above, best-practice is to keep the NUA stock in its own account (separate from other non-qualified assets).
- NUA is not an “all or nothing” strategy. The client can selectively choose which shares they want to transfer in-kind (ideally the shares with the lowest cost basis) and roll over the rest to an IRA.
- If the client is about to take their first RMD from the plan, an NUA distribution could satisfy the RMD, but the order is important. The IRS requires the first dollars out be considered the RMD.

4 TRIGGERING EVENTS:

An NUA distribution can only occur after a triggering event. Any distribution from the plan that occurs after the triggering event must be the tax year for the NUA distribution (or the opportunity is lost until the next triggering event). Once a triggering event has been missed, it's “crossed off the list” but there may be other triggering events the client could use to process NUA. See example below (Sarah). She has stock in her employer plan that she'd like to use NUA with:

Disability



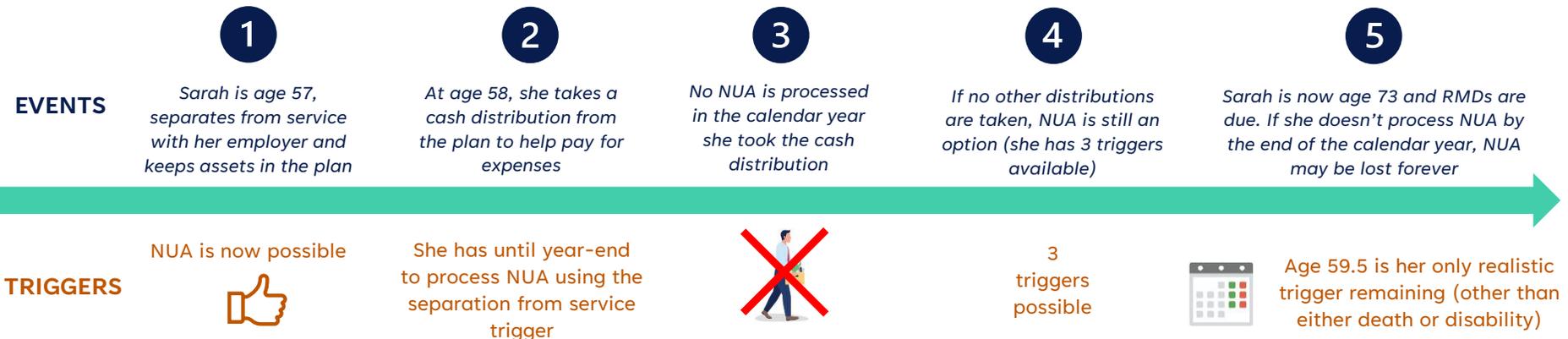
Death



Separation from Service



Age 59.5



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An outline to help determine if the client is an ideal candidate for the strategy



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