PACIFIC LIFE insights

RETIREMENT STRATEGIES GROUP

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WHO CAN BENEFIT FROM THE NET UNREALIZED APPRECIATION (NUA) STRATEGY?

Do you have clients with highly appreciated stock in a 401(k) or other employer-sponsored retirement plan? Are they about to retire and may be interested in minimizing taxes? There's a strategy that may help; it's called NUA.

What Is Net Unrealized Appreciation (NUA)?

When a participant needs to decide between a distribution of company stock or taking its cash value from a 401(k) plan, a choice must be made: roll it into an IRA, or distribute the company stock into a taxable account and roll the remaining assets into an IRA.

Participants who elect a lump-sum distribution of the company stock to a taxable account pay only ordinary income tax on the stock's cost basis: that is, the price paid for the stock. If the participant is younger than age 59½, he or she also may be subject to an additional 10% federal tax.

When shares of the stock are eventually sold, the participant will pay long-term capital gains (LTCG) tax on the stock's NUA: that is, the difference between the price initially paid for the stock (cost basis) and its current market value. Any post-distribution growth also will be taxed then, as either short-term capital gains (STCG) or long-term capital gains, depending on the holding period after the distribution.

What Is a Lump-Sum Distribution?

A participant must meet all the following conditions to qualify for NUA:

- Experience a triggering event:
  - Separation from service
  - Attainment of age 59½
  - Permanently disabled
  - Death
- Distribute the company stock from the 401(k) or qualified plan in-kind to a taxable account.
- Distribute all remaining assets from the 401(k) or qualified plan with that employer within one tax year.

Who Can Benefit from the Net Unrealized Appreciation Strategy?

The NUA strategy primarily benefits individuals who own appreciated employer stock in a 401(k) or other employer-sponsored retirement plan. The higher the income-tax bracket and the more the stock has appreciated, the more a participant may benefit from this strategy.

Net Unrealized Appreciation Example

The NUA will be taxed at favorable long-term capital gains rates when the stock is sold. Any post-distribution growth also will be taxed then, as either short-term or long-term capital gains, depending on the holding period after the distribution.

In the following example, the $5,000 of appreciation accrued after the lump-sum distribution will be taxed as either short-term or long-term capital gains, depending on the holding period.

Appreciation Outside Plan: Holding period determines tax treatment	**$5,000**	**Taxed as LTCG or STCG when stock is sold**
Appreciation in the Plan: Stocks NUA	**$190,000**	**Taxed as LTCG when stock is sold**
Value When Contributed: Stock basis	**$10,000**	**Taxed as ordinary income when stock is distributed**

For more information on NUA rules as well as situations that trigger additional tax restrictions, review IRS Publication 575, [Pension and Annuity Income.]

As always, participants should seek guidance and consult their personal tax advisors to help determine whether the NUA strategy is an appropriate course of action based on their specific situations.

Additional Information and Links

IRS Publication 575
www.irs.gov/publications/p575

For additional information about the NUA strategy, please contact the Retirement Strategies Group at (800) 722-2333, ext. 3939, or email RSG@PacificLife.com.

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