UBS

# Have a 401(k) with company stock?

## Explore a little-known tax break for appreciated shares

If you have a 401(k) plan account with a former employer that holds appreciated company stock, you may have an opportunity for special tax treatment on your shares. This is one of those rare situations where it may *not* make sense to roll over your entire distribution into an Individual Retirement Account (IRA). Instead of rolling it over, you may want to consider taking this portion as a lump-sum distribution that could qualify you for favorable treatment on the stock's net unrealized appreciation (NUA).

### What is NUA?

Net unrealized appreciation is the difference between the price you originally paid for the stock (known as its cost basis) and its current market value. For example, say you bought a share of company stock for $10 through your 401(k) plan. If the share is now worth $25, the appreciation is $15 per share. Since you have not yet sold the share, however, the appreciation has not been realized—thus, "net unrealized appreciation."

### How it works

The NUA strategy provides favorable tax treatment such as:

- **Long-term capital gains versus ordinary income tax rates—**If you take an "in-kind" lump-sum distribution of the stock from the 401(k) plan and put it in a taxable account, you would have the potentially significant benefit of shifting what would otherwise be ordinary income to a long-term capital gain when you sell your shares. Since the maximum federal capital gains tax rate is currently 20%, far lower than the 39.6% top income tax rate, your potential tax savings could be substantial.

- **Ability to deduct your losses—**If the value of your employer stock declines below your original cost basis while you hold it outside an IRA, you may be able to sell it and deduct the loss against realized gains you have that year. This is not possible inside an IRA or 401(k).

- **Preserving your estate—**Tax on the NUA portion of stock held outside an IRA is deferred until the stock is ultimately sold. Your beneficiaries would be responsible for capital gains taxes on accumulation that occurred inside your 401(k) plan. Any further accumulation that occurs after distribution and up until the time of your death may receive a stepped-up cost basis, meaning it will pass to your beneficiaries free from federal income or capital gains tax.

### Who should consider the NUA strategy?

If the employer stock in your plan has little or no appreciation, you may not want to consider the NUA strategy, or if you cannot afford to pay the taxes and/or early distribution penalty on the cost basis of the stock.

You may want to consider it if you:

- Have highly appreciated employer stock
- Are in a high tax bracket
- Can afford to pay current taxes
- Have a diversified portfolio
- Will avoid the 10% penalty on the cost basis of the distribution (if you separate from service during the year you become age 55 or later, and then receive a distribution from your former employer's retirement plan, you will not be subject to the 10% penalty.)

**Example: How to save over $16,000 in taxes on $100,000 worth of company stock**

**$100,000 in company stock held in 401(k) account**

| | | | |
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| **Take distribution** | **Standard 401(k) distribution**<br>Cash out $100,000 | | **NUA treatment on company stock**<br>Distribute in-kind and sell shares |
| **Minus taxes*** | **$100,000 x 0.33<br>= $33, 000** | **33% ordinary income tax rate** | **Cost Basis<br>$10,000 x 0.33 = $3,300** |
| | | **15% long-term capital gains tax rate** | **Appreciation<br>$90,000 x 0.15 = $13,500** |
| **Final balance** | **$67,000** | | **$83,200** |

**Total tax savings = $16,200**

* Assume a 33% ordinary income tax rate and 15% long-term capital gains tax rate. Tax rates reflect federal taxes; state taxes may also apply.

This is a hypothetical illustration, not meant to be indicative of any particular product and/or investment.

## Let's have a conversation

Due to the highly complex nature of retirement plan distributions, you should discuss your options for your company with your legal and/or tax advisor before making any final decisions. Let's review your current situation, explore your options and create a plan that best fits your circumstances.

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