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Tax on long-term gains less than straight income

Are you considering retirement soon? Do you have a lot of appreciated company stock in your 401k or other employer-sponsored plan? If so, read on. There may be a tax-saving strategy for you.

Net Unrealized Appreciation (NUA) allows you to transfer your company stock from your retirement account into a taxable account, not a rollover IRA, and pay ordinary income tax on only the cost basis of the shares.

Your company retirement plan tracks your cost and reports the basis to the IRS in the year of the transfer to the taxable account.

The shares may be sold at any time in the taxable account and you pay only long term capital gains tax on the difference between the cost basis and the sales price. Ordinary income tax rates are as high as 39.6% while long term capital gains tax rates range from 0 to 20%.

The taxpayer must be over the age of 59.5 or there may be a 10% penalty for early withdrawal.

NUA is used at or after termination of employment, or in the event of the employee's disability or death.

The company stock must be transferred as an "in-kind lump sum distribution" in a single calendar year. If you roll your company stock into an IRA, you can't use this strategy.

I like hypotheticals. Let's assume that John Q. Public is 60 years old and plans to retire on 1/1/2017. John has company stock valued at $100,000 in his 401k and the cost basis is $25,000. His 2017 income will put him in the 25% marginal tax bracket (this includes the $25,000 cost basis of his company stock). If he utilizes the NUA strategy and sells the stock for $100,000, he'll pay about $11,250 capital gains tax on the $75,000 and about $6,250 in ordinary income tax on the $25,000 cost basis. Compare that to paying ordinary income tax of 25% on the entire $100,000.

This is a useful and somewhat complicated tax strategy. Measure twice, cut once and most of all, work with a professional.

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