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 be able to take advantage of special tax treatment. Instead of leaving the company stock in the plan or rolling it over to an IRA or new employer plan, if you take this as a lump-sum distribution, you could qualify for favorable treatment on the stock's Net Unrealized Appreciation (NUA). The remainder of your lump-sum distribution (non-company stock) can be rolled over to an IRA.

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

If you take an "in-kind" lump-sum distribution of the employer stock in your 401(k) plan and put it in a taxable account, here's how the NUA strategy provides favorable tax treatment:

- **Ordinary income tax only on the cost basis of the stock**—only the cost basis of the stock is taxable as ordinary income at the time of distribution, while the tax on the appreciation is deferred until you sell the stock.

- **Long-term capital gains versus ordinary income tax rates**—the tax on the net unrealized appreciation is not due until you sell the stock, and then at long-term capital gain rates rather than ordinary income tax rates. Since the maximum federal capital gains tax rate is currently 20%, far lower than the 37% top income tax rate, your potential tax savings could be substantial.

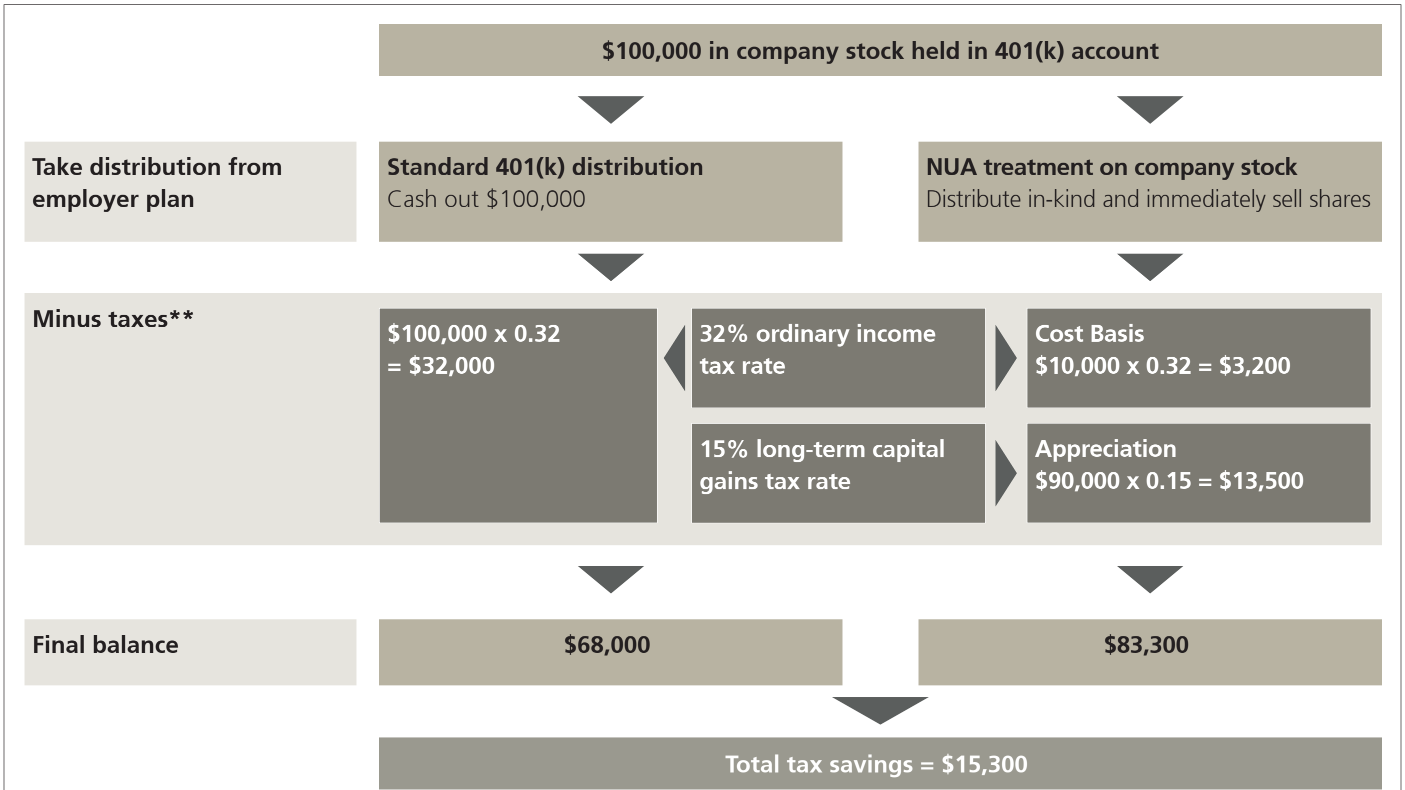
- **Ability to deduct your losses**—If the value of your employer stock declines below your original cost basis while you hold it outside an IRA, you may be able to sell it and deduct the loss against realized gains you have that year. This is not possible inside an IRA or 401(k).

- **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 would pass to your beneficiaries free from federal income or capital gains tax.

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.)

It's important to balance the advantages of this special tax treatment for employer stock with the risks of maintaining too concentrated a position in one stock, particularly with your retirement money that you may need to last you throughout your retirement years. Using the NUA strategy is not an all or nothing proposition—you can choose to only maintain some of the employer stock while diversifying the balance after rolling it over to an IRA or new employer's plan.

Example: How to save over $15,000 in taxes on $100,000 worth of company stock



** Assume a 32% 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 stock with your legal and/or tax advisor before making any final decisions. Let's review your current situation, explore your options and discuss what may best fit your circumstances.

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