FUND DIRECT ADVISORS

A Tax Strategy for your 401(k)

Did you know the 401(k) was created when Congress passed the Revenue Act of 1978? That means the retirement savings plan will celebrate it's 45th Anniversary in 2023!

According to the Investment Company Institute, 401(k) plans hold an estimated $7.3 trillion in assets: representing nearly one-fifth of the $37.2 trillion United States retirement market. For many Americans, their 401(k) is their primary source to fund their retirement.

The way your Traditional 401(k) works:

- Employees contribute to their plan with pre-tax dollars (they receive a tax deduction the year they contribute).
- The money grows tax-deferred (they do not have to pay tax on gains in the account when they occur).
- When they retire and need the money to fund retirement, they pay ordinary income tax (Federal and State based on applicable tax bracket).

Did you know there may be more tax savings in your 401(k) if you own Company Stock in your account?

If you work for a company that allows the purchase of company stock inside your 401(k), or they provide a match with company stock in your 401(k), you may be eligible for a tax break. A little used IRS rule could potentially provide for a more favorable tax treatment of that company stock: Long-Term Capital Gains.

What is Net Unrealized Appreciation?

Net Unrealized Appreciation (NUA) is the difference between the current market value of the shares of employer stock and the original cost basis. The IRS allows participants to move company stock held in a 401(k) into a taxable investment account and have the appreciation be subject to Long-Term Capital Gains taxes. You'll still be required to pay Ordinary Income Tax on what you paid for the stock, or the Cost Basis, at the time of this election. However, if you have significant appreciation in the stock, you could save thousands of dollars on taxes!

The maximum long-term capital gains tax bracket is 20%. Compared to the maximum ordinary income tax bracket of 37%. Therefore, the potential savings could be significant, given your current and future tax bracket.

Why investigate Net Unrealized Appreciation (NUA)?

Greater Tax Diversification – You now have access to money at a potentially lower tax rate. Creating more tax-savings in retirement could help you increase your lifestyle and/or have your assets last longer.

How to qualify for Net Unrealized Appreciation (NUA)?

1. Distribute the full balance of your 401(k) within one tax year.
2. You must experience one of the following:
    a. At least age 59.5
    b. Separation from service (for non-self-employed individuals)
    c. Disabled (self-employed individuals only)
    d. Death of participant
3. NUA-eligible shares moved in-kind to a taxable account

What should I do to see if I qualify for Net Unrealized Appreciation (NUA)?

Obtain a copy of your most recent 401(k) statement and see if you own company stock in your 401(k) account. If you own company stock in your 401(k) and plan on retiring soon, reach out to see if Net Unrealized Appreciation makes sense for your financial situation.

Note: If you own company stock in an Employer Stock Ownership Plan (ESOP), your shares may also be eligible for Net Unrealized Appreciation (NUA) tax treatment. This is also inclusive of some Privately Held Stock ESOPs.

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