

How the NUA rule works

If a portion of your plan assets is invested in highly appreciated employer stock, and you are considering rolling the assets into an IRA, the NUA rule may offer a tax advantage. To benefit:

1. You would withdraw all of your retirement plan assets — including the stock in-kind (as shares) — and roll over to the IRA only your non-stock assets.
2. You would pay ordinary income taxes on the cost basis of the stock at the time of the distribution.
3. The difference between the current market value and the cost basis of the employer stock at the time of the distribution is known as the net unrealized appreciation (NUA). When the stock is sold, the NUA would be taxed at long-term capital gains tax rates — currently a maximum of 15% — instead of ordinary income taxes. Any subsequent appreciation above the NUA would also be taxed at the same long-term capital gains tax rates if the stock is held for at least one year after the distribution.
4. Compare this NUA treatment to what would happen if the employer stock is rolled over to an IRA or liquidated in the plan and the proceeds rolled over. Distributions from the IRA would be taxed as ordinary income and the benefits of any NUA would be lost.

Example

Clark owns 500 shares of employer stock in his retirement plan with a cost basis of \$10 a share.	$500 \text{ shares} \times \$10 = \$5,000$
When Clark leaves the company, the stock is trading at \$40 a share.	$500 \text{ shares} \times \$40 = \$20,000$
The NUA of the stock is therefore \$30 a share or \$15,000.	$\$40 - \$10 = \$30$ $500 \text{ shares} \times \$30 = \$15,000$
Now let's say Clark is in the 28% income tax bracket and rolls the full \$20,000 into an IRA.	
If he were to withdraw that amount at a later time, the ordinary income tax on the distributions would be \$5,600.	$\$20,000 \times 28\% = \$5,600$
If Clark uses an NUA strategy and sells the stock immediately after the distribution, the taxes would be calculated as follows:	tax on basis: $\$5,000 \times 28\% = \$1,400$ tax on NUA: $\$15,000 \times 15\% = \$2,250$ total tax: $\$1,400 + \$2,250 = \$3,650$
Taxes with NUA \$3,650 < Taxes with rollover \$5,600	