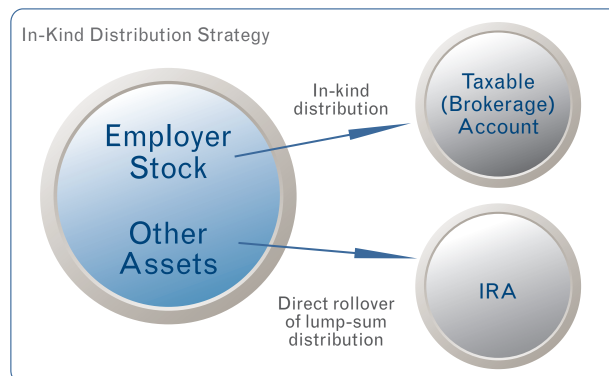
GOT EMPLOYER STOCK?

Consider the difference in tax rates when performing a rollover

When thinking about moving assets from an employer's retirement plan, you have many options. Employer stock, particularly if it has grown significantly, can have a big impact on how you take assets from the plan. Why? Mostly because of taxes. You may want to consider taking an "in-kind" distribution vs. a more traditional rollover to an IRA. An "in-kind" distribution is typically a payout of stock rather than cash.

Taxes are the biggest decision factor. Upon withdrawal, assets in an IRA are taxed as ordinary income. This means any sale of employer stock rolled over to an IRA would tax the total sale value at ordinary income rates. However, when distributed in-kind, you would pay ordinary income tax upfront on the cost basis of the stock (i.e., the total cost to the employer for the stock) and move the stock to a "taxable" or brokerage account. Upon sale of the stock in this case, you would pay taxes at the long-term capital gains rate on the net unrealized appreciation (NUA), which is the difference between the cost basis and the current fair market value of the stock. Since the long-term capital gains tax rate (as of 2012) is currently lower than most ordinary income tax rates, you would see substantial tax savings through an in-kind distribution.

For this strategy to work, the client must take an in-kind distribution of all or some of their employer stock as part of a lump sum distribution. This does not mean everything has to be taken as a taxable distribution. Remaining assets from the lump-sum distribution can be rolled to an IRA, but no assets can remain at the employer. The rollover should be direct to avoid the mandatory 20% withholding.



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HYPOTHETICAL EXAMPLE

Saving on taxes with an in-kind distribution

Lisa is 65 years old. She retires from Sun Company with 1,000 shares of company stock with a fair market value of $50,000. Because Lisa's employer stock was awarded at a price of $10 per share for a cost basis of $10,000, her net unrealized appreciation (NUA) is $40,000 ($50,000 minus $10,000).

Assuming a 25% federal tax bracket on an in-kind distribution, Lisa will pay $2,500 on the original cost basis of the stock. The $40,000 of appreciation, or NUA, is tax-deferred until sold, at which time it would be taxed at the long-term capital gains rate of 15% in 2012, which equates to $6,000.

Should Lisa opt to roll over the total lump sum to an IRA, the full amount will be tax-defered until distributed, at which time it would be taxed at the ordinary income rate. If she distributes the full $50,000, the tax will be 25% of $50,000 ($12,500).

Assuming Lisa sells her stock when the NUA is valued at $40,000, she would save approximately $4,000 in taxes by using the in-kind distribution approach. However, if that stock continued to appreciate before selling it, she will benefit even further as earnings will be subject to the capital gains tax rate – assuming it remains lower than her ordinary income tax rate.

DISTRIBUTION OPTIONS FOR EMPLOYER STOCK			
In-Kind Distribution:		Rollover to IRA:	
$10,000 x 25% =	$2,500	$50,000 x 25% =	$12,500
$40,000 x 15% =	$6,000		
Total Taxes Paid:	**$8,500**		**$12,500**
		Difference: + $4,000	

Considerations:

- This strategy is most effective given the current favorable tax treatment of long-term capital gains. Changes to the tax code in the coming years could impact decisions you make relative to employer stock – be sure to consult with your tax advisor.
- If you have a large concentration of employer stock in your portfolio, rolling this stock into an IRA can provide you with an opportunity to diversify your investments.

Consult with your Raymond James financial advisor to discuss whether an in-kind distribution would be appropriate for your situation. There are many factors involved and steps that must be implemented correctly in order to make the most of your decision.

IRA withdrawals may be subject to income taxes, and prior to age 59 1/2 a 10% federal penalty tax may apply.

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