Season 1 – Episode 2: Unlocking Tax Savings: Exploring Net Unrealized Appreciation (NUA) in Retirement and Estate Planning

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Host: Daniel J. Rohr, CPA/PFS, EA, M.S. Tax

Welcome to Tax Blueprints, a Rohr CPA's podcast. I'm Daniel Rohr, the managing shareholder of Rohr Associates, a premier CPA firm based in California. I'm a CPA Personal Financial Specialist and Enrolled Agent. I have extensive experience advising individuals and business owners with tax minimization and personal financial planning strategies. On each episode of Tax Blueprints, I delve into the intricacies of tax laws, explain the subtleties of business tax planning, and guide individuals towards the path of financial stability. Whether you're a business owner navigating the murky waters of taxation or an individual planning for a worry-free retirement, Tax Blueprints will provide you with the tools and knowledge you need. I hope you enjoyed this episode.

Today, we're delving deep into a strategic tax concept known as Net unrealized appreciation, or NUA, which is a significant but often overlooked strategy that can offer substantial tax advantages in retirement and estate planning. Before we dive in, it's important to clarify this episode is meant for educational purposes only and should not replace personalized advice from a tax professional. Everyone's financial situation is unique. So please consult your tax advisor before making any big decisions.

So what exactly is NUA? In simple terms, NUA represents the difference between the original cost of employer stock held in an employer sponsored retirement plan like a 401K and its market value at the time of distribution. Normally distributions from these accounts are taxes ordinary income, but with NUA the appreciation part is taxed, long term capital gains. Which can be significantly lower than ordinary income tax rates. Now that's where the tax saving magic happens.

To illustrate, let's consider you have employer stock in your 401K that was purchased for $20,000 is now worth 120,000. If you were to roll that over into an IRA and then take a distribution, the entire 120,000 would be taxed as ordinary income. But if you use the NUA strategy. You'll only pay ordinary income tax on the original $20,000. The remaining 100,000 of appreciation will be taxed at the long-term capital gains rate when you sell the stock.

Now let's bring the retirement income tax benefit into the picture. By utilizing anyway, you can strategically lower your retirement income as you know your Social Security benefits. Taxability is contingent on your combined income. Which includes your taxable IRA distributions. By reducing these distributions through NUA, you can potentially lower your overall retirement tax bill.

And moving into estate planning benefits. NUA can be a powerful tool. When you pass on your heirs receive a step up in basis on inherited assets, meaning they aren't liable for the appreciation during your lifetime if you've utilized the NUA strategy. The basis of the stock becomes the market value at the time of your death, eliminating any capital gains tax on that appreciation. In addition, you have moved money out of a tax deferred account that would have been subject to require minimum distributions after reaching the age of 73 or 75 depending on your current age. However, bear in mind that the NUA strategy isn't a 1 size fits all solution.

It has specific criteria and regulations that you must meet to qualify. First and foremost, the stock must be distributed from your employer sponsored retirement plan as part of a lump sum distribution. This means that all of your assets from your account, not just the employer stock, must be distributed within one calendar year. This doesn't mean you're paying taxes on the entire distribution though. You would send the company stock in kind to a taxable brokerage account. And directly roll over the rest to an IRA. This lump sum distribution is typically triggered by certain events, such as reaching the age of 59, 1/2 retirement, or in some unfortunate cases, death or disability.

Second, the stock must be moved in kind into a taxable account. This means you're not selling the stock, but moving it as is. If you sell the stock while it's still in the retirement plan, the NUA opportunity is lost.

3rd The stock must have been purchased with pretax dollars or a tax-deductible contribution. If it was purchased with after tax dollars, the NUA strategy doesn't apply. Lastly, the NUA tax benefits are most noticeable when there's significant appreciation of the stock's value. If the stock hasn't appreciated much, the tax advantage may be minimal. Similarly, if you need to liquidate the stock soon after the distribution, you may not fully reap the NUA benefits as the stock's appreciation will be taxed upon the sale.

These are the main criteria to be aware of when considering the NUA strategy. As always, everyone's financial situation is unique and therefore it's crucial to consult with your tax advisor to ensure that the NUA strategy is the right fit for your financial goals and circumstances.

Now to sum it up. The NUA strategy is a potentially powerful tool for minimizing taxes and maximizing wealth, both for your retirement and your estate. It exemplifies the importance of understanding the nuances of tax laws to help you make more informed financial decisions.

That's all for this episode of tax blueprints of Rohr CPA's podcast. You can find us online at rohrcpas.com/podcast and don't forget to subscribe on Apple Podcasts or Spotify. If you enjoy the show, please consider rating or reviewing us wherever you listen. I'm your host Daniel Rohr. Thanks for listening.

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