NET UNREALIZED APPRECIATION

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FOR READERS NEARING RETIREMENT, IT IS ADVISABLE TO REVIEW YOUR INVESTMENT ALLOCATION. Yes, the stock market has attained all-time highs as recently as July 15, 2019, and that is notable because people think more about retirement as late stage bull markets reach new heights. Swelling 401(k) balances logically seem congruent with near-retiree optimism and confidence that you may have finally achieved a nest egg sufficient to carry you through your golden years.

Yet even for those with fattened quarterly statements, it's a healthy reminder to make sure your allocation reflects who you are as an investor today. Since you are no longer a 20-something-year-old starting out in your career, your allocation and exposure to risk matters more as you eagerly approach the retirement date you've penned in your calendar.

The WSJ published an article on August 4, 2019 titled, *About to Retire? Watch Your Stock Exposure—Quickly*, and it highlights the importance of recognizing the "sequence of returns" that an investor earns and the impact those returns have on the investment portfolio over time. The interesting and maybe surprising reality is that those who retire near a bull market high and kept an allocation heavy in equities often have meaningfully less in their portfolio years later. The reason they have less is because they will suffer from "the double whammy" effect if stock markets sell off while they maintained both an equity driven portfolio along with taking distributions of 4% annually to complement their retirement income. The impact that distributions can have on a portfolio decreasing in value is significant and can hinder the outcome over a retiree's lifetime.

If you are an investor who owns publicly traded employer stock in your 401(k) account, there is a nuanced decision that you can think about called Net Unrealized Appreciation or NUA. The idea is applicable to employer stock in a 401(k) plan like Lockheed Martin (LMT) or any other publicly traded company. The nuance is this: typically when an employee retires from a company they may choose to do an IRA Rollover. When they do, all of their assets move to the IRA and remain tax-deferred. You only pay ordinary income taxes as you decide to take withdrawals from the IRA account. With Net Unrealized Appreciation, there is a tax benefit that you can utilize if you wish to continue to own the employer's publicly traded company stock.

The tax benefit can occur when instead of rolling the stock in your 401(k) to an IRA Rollover, you transfer the shares to a taxable brokerage account (think your Joint account or Trust account) whereby you avoid ordinary income tax on the stock's Net Unrealized Appreciation. The only part of the stock that is subject to ordinary income tax is the value or cost basis of the stock in your account as it was acquired by your 401(k) plan. So, if you bought and accumulated employer stock in your 401(k) over the past 30 years and the stock has climbed in value, you would only pay ordinary income tax on the price you paid for the stock. All of the position and the gain in the stock would then be held in your after-tax account and subject to the lower capital gains tax rate when you decide to sell—potentially an enormous tax savings!

Of course, there are certain requirements that must be met, which include that the distribution of the employer stock must be in-kind; the distribution must be made in a lump sum, which means that the entire account balance of the employer retirement plan must be distributed in a single tax year whereby other assets not subject to the in-kind NUA distribution may be rolled over to an IRA; the lump-sum distribution must be made in the year of a triggering event, such as separation from employer, death, disability or when the employee reaches age 59.5; and an important caveat is that the NUA gain will not be eligible for a step-up in basis at death. The NUA strategy may be beneficial for those whose company stock has significantly appreciated in value, but it is important to note that there are risks to holding a large portion of your retirement in any one security. Alternatively, leaving assets in the plan or completing an IRA rollover may be more preferable than taking a lump-sum distribution to accomplish the NUA, given that the basis would be immediately fully subject to ordinary income taxes.

There are various strategies to help maximize one's portfolio and to minimize the taxes, but consulting with a tax professional and/or a professional in portfolio and wealth management will help you identify which of these techniques are relevant for you as you approach retirement or even if you are just starting out.

Jeff Runyan is the lead of Runyan Capital Advisors financial advisory team based in Beverly Hills, providing clients nationwide with wealth management and retirement planning advice. Backed by over two decades of industry experience, Jeff leads an investment team committed to designing investment portfolios that adhere to the premise, "Discipline Makes the Difference." Learn more at ***RunyanCapital.com.***

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