Please note: This is a transcription so there may be slight grammatical errors.

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If your employer sponsored retirement plan contains company stock, you may have heard of a strategy called net unrealized appreciation. When executed correctly, net unrealized appreciation could help you reduce your tax bill when you withdraw money from your retirement plan.

If you have company stock in a 401k or another employer sponsored retirement plan, you may be able to use a strategy called net unrealized appreciation, or NUA. This strategy allows you to swap the income tax that's normally applied to retirement plan distributions for the more favorable treatment of long-term capital gains tax on a portion of the funds. Depending on your tax bracket, your income tax may be up to 37%, but long-term capital gains tax is capped at 20% and maybe even lower. The NUA is the difference between the current value of the stock and the cost basis, or the price of that stock when it was acquired by the plan. For instance, if the original price of the stock was $250,000 and its current value is $1 million, the NUA would be $750,000.

Let's say you are in the highest possible tax bracket without using an NUA strategy, you will pay about $370,000 in total income tax on the stock as distributions are taken over time. That's 37% of the full $1 million, and the dollar amount could be higher if the account continues to grow. But by using an NUA strategy, you may be able to reduce that tax bill significantly. Instead of paying a 37% income tax on the full amount, you'll pay income tax only on the cost basis. Then you'll pay a lower 20% long-term capital gains tax on the NUA amount. Another advantage of this strategy is that both taxes will not need to be paid at the same time. The long-term capital gains tax on the NUA portion does not happen until the appreciated stock is actually sold. To take advantage of the NUA strategy, there are some features that need to be available in your plan.

First, the plan must allow for NUA. If it does, the rest of these features are also likely available. Second, you need to have the ability to take employer stock from the plan. This is often known as an in-kind distribution. It is important to understand that NUA can only be done after certain triggering events. Most individuals will only have one or two opportunities to use this strategy during their lives. An NUA strategy follows these steps. First, a lump sum distribution must occur as the first transaction after a triggering event. In this case, lump sum just means that all the funds must leave your account. It does not mean that all the funds must be taxable. The funds not involved in the NUA transaction can be rolled over into a tax-deferred individual retirement account. Then the company stock should be moved into a taxable brokerage account separate from your retirement accounts.

When this happens, you'll pay income tax on the cost basis of the employer stock. Remember, the cost basis is the price of the stock when it was acquired in the plan. More than likely you acquired the stock over time. You'll need to reach out to your record keeper to get the cost basis value. In our earlier example, the cost basis was $250,000. If you sell the shares immediately, you'll pay long-term capital gains tax on the difference between the cost basis and the value of those shares when they left your employer plan. If you continue to hold the shares of stock, you'll pay short or long-term capital gains tax on the post distribution gain based on the holding period.

It's important to note that NUA is not right for everyone. It's most effective for people in higher income tax brackets who have a large amount of company stock in their retirement plan at a low cost basis. It's also important to consider the potential risks of holding a large amount of company stock in your portfolio, as it can be volatile and may not diversify your retirement investments. Note that the NUA strategy changes how your retirement plan assets are taxed for those who inherit them. To determine if NUA is right for you, consult your CAPTRUST advisor or tax professional. We can help you evaluate both the potential tax savings and risks for your unique circumstances.