Donating Employer Stock from a Retirement Plan ©

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Many employees with large portions of their retirement assets in company stock now understand all too well the risk of having a concentrated position in their portfolio; witness the lawsuits that developed after employees at Enron, WorldCom, and other firms saw the value of their retirement plans drop sharply as their companys stock value plunged on news of corporate malfeasance.

How can you protect your retirement assets from volatility? If you are planning on leaving a job and have a large amount of company stock in your 401(k) or other employer-sponsored plan, you may have a special opportunity to benefit your favorite charities and get a generous tax break. Donating this stock to a charitable remainder trust (CRT) can provide you with an ideal after-tax outcome, while also allowing you to fulfill your philanthropic intentions.

Bob Keebler, shareholder in the accounting firm Virchow, Krause & Company LLP of Green Bay, Wisconsin, gives an example. One of his clients, a 30-year veteran at a major corporation, had retired in his early 60s after accumulating a retirement account that was well into the seven figures.

Normally, a retiring executive would roll over such a retirement account into an IRA, maintaining the tax deferral. However, this executives retirement account held only appreciated employer stock. "This made him an ideal candidate to take advantage of a helpful provision in the tax code," says Keebler. "It's known as the NUA tax break, for net unrealized appreciation."

How NUA Works

When an employee leaves his or her company, employer stock can be withdrawn from the plan. Income tax is owed, at ordinary tax rates, but only on the cost basis of the shares -that is, the value of the shares when they were contributed to the plan.

"For example, if the shares withdrawn from the plan were valued at $200,000 when acquired by the plan, the employee would owe tax on $200,000 worth of ordinary income," says Ed Slott, a CPA in Rockville Centre, New York, and publisher of Ed Slotts IRA Advisor newsletter. "That's true even if the shares are now valued at $1 million."

For Keebler's client, the shares were trading at more than $80, but the cost basis was less than $15. Therefore, the client decided to withdraw most of the employer stock and pay tax on the cost basis. If tax is paid on the $15 basis of $80 shares, the $65 balance-the net unrealized appreciation, or NUA-could go untaxed.

Tax-Efficient Diversification with a CRT

This maneuver can save you money, but it doesnt resolve a key remaining issue: diversifying the

concentrated position in a tax-efficient manner.

One solution for reducing the risk of a concentrated portfolio is to simply sell the NUA shares. Another approach is to roll the shares into an IRA, sell them, and reinvest the proceeds. However, neither strategy fully eliminates taxes ultimately due on the assets; Uncle Sam will eventually earn his share in both cases.

That's why Keebler's client chose a third, more charitable solution: contributing a large portion of net unrealized appreciation (NUA) stock to a charitable remainder trust (CRT). Then, acting as trustee, the client sold the shares. The sale was tax-free, inside a charitable trust," explains Keebler. "Then all of the proceeds could be reinvested in a diversified portfolio."

Realizing Your Charitable Intentions

With a CRT, the trust balance eventually will go to a designated charity or charities. "My client named several charities, including a local community foundation," says Keebler. Meanwhile, the clients income beneficiaries receive a fixed percentage of income for their lifetimes.

With this approach, the creator of the CRT will get a current tax deduction for the future charitable donation. This deduction, which will be a fraction of the amount transferred to the trust, can help to offset the taxes incurred when the NUA stock is withdrawn from the plan. In addition, there is an estate planning benefit: The value of the employer shares transferred to the CRT will be out of the donors taxable estate, along with any future appreciation.

Playing It Safe

What are the risks to this strategy? NUA shares that are donated to a CRT will pass to a charity, not to heirs. Therefore, donors should be sure that they have other plans to leave a legacy to loved ones.

On the tax side, the main risk is that the IRS might consider the deferred capital gains tax to be triggered when the NUA shares are transferred to a CRT. The IRS has said that's not the case, in private letter rulings," says Keebler. "Such rulings are not binding on other taxpayers, though, so you might want to get your own private ruling, especially if large amounts are involved."

Donating your appreciated employer stock through a charitable remainder trust may be an ideal solution to help you support your favorite charities. The tax benefits can help you maximize the size of your charitable gift, while reducing the risk of having a concentrated position in your portfolio can ensure your security in retirement.

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