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'Money $ense': Company stock and your retirement srategy

Sep 25, 2021

One investment option sometimes seen inside a qualified employer retirement plan, such as a 401(k), is company stock. This can be a great benefit that you can purchase.

Other opportunities for obtaining company stock include stock options or stock bonuses. Another option is purchasing stock through an employee stock purchase plan (ESPP), which is a plan that typically sells employer stock at some kind of discount and holds the shares in a taxable account.

Company stock can be a valuable option. If you do decide to make the purchase, the chances are you know something about the company and its prospects. Just don't let this knowledge lead to an outlook that is too rosy.

Having too much stock is problematic if the company or the market sector it operates in comes on hard times. Your stock investment could lose its value at just the same time you lose your job.

There are some prudent ways to manage company stock. The first is to have diversification in your portfolio. A single holding should not make up a large percentage, such as over 10%, of your portfolio's overall value.

Having a single large position is termed "concentration risk." Investors could be exposed to concentration risk through a single investment, asset class or market segment.

This type of risk is subject to the possibility of large losses.

Almost all companies face changing markets, new regulations and evolving technologies. Remember that there are risks inherit in any business. Company stock is no exception.

When evaluating concentration risk, remember that concentrated positions can build over time. What started as a modest allocation in your portfolio can grow to a large position if the company is successful.

It is important to monitor the situation and consider adding exposure to other types of asset classes. You will want a wide variety of investments to effectively diversify your assets.

Take particular care when selling company stock. Make certain you are aware of the rules of your plan and any tax considerations. There could be time frames to meet and tax consequences to pay.

The type of plan the stock is in determines the rules. With employer stock, one important consideration is something called "net unrealized appreciation" (NUA). Distributions from 401(k)s are typically taxed as ordinary income. The same result occurs when you roll your 401(k) into an IRA at termination.

Distributions from IRAs are generally taxed as ordinary income. However, employer stock within retirement plans has the potential for different treatment — NUA.

This provision allows any gains on company stock to be taxed at long-term capital gains rates once the stock is sold.

This could be a big tax break since capital gains rates are generally lower than ordinary income tax rates.

To qualify for NUA treatment, the stock has to be part of a lump sum distribution following a triggering event such as death, disability, retirement or reaching age 59½.

The stock needs to be distributed as stock and it needs to be transferred into a taxable account.

In the year of the distribution, you will owe taxes on the cost basis of the stock.

When utilizing NUA treatment, it should be noted that the other assets inside the retirement plan can be rolled into an IRA or other employer plan.

The rollover and distribution of stock need to happen during the same tax year. The point is to have a zero balance in your employer plan at year end.

NUA transactions can be tricky, so it may be best to work with an accountant or certified financial planner. Working with a professional will allow you to review your entire situation and discuss your options before proceeding with any transactions.

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