

Rolling Over Employer Stock to an IRA Could Be a Mistake

As decades of work come to an end and the transition into retirement begins, retirees must generally grapple with the issue of what to do with the funds they've accumulated in their companies' retirement plans. Often, the decision is made to roll such funds over into an IRA. After all, an IRA does preserve their tax-deferred nature. And in most cases, that IRA will also allow for increased investment flexibility. So, is a Rollover IRA the no-brainer it appears to be? Not necessarily.

If you hold a significant amount of *appreciated* employer stock within your employer's retirement plan and you are soon to retire, you should know that you can receive some pretty favorable tax treatment on that stock – if you play by the rules. First, let's take a look at the tax break itself.

If, upon separating from service or turning 59½ years of age, you take a lump-sum distribution from your employer's retirement plan, you may then roll all *non*-employer stock over to an IRA just as you otherwise might. Those IRA funds then remain tax-deferred as they normally would.

What happens to the employer stock you own? You either stash the certificates in your sock drawer, or more preferably, transfer the shares to regular, taxable brokerage account. Either way, the income tax imposed on the employer stock portion of your distribution is based on your regular income tax rate, but that rate is applied only to the *cost* of that stock – not its *value*.

Let's say that over your career you paid \$50,000 to accumulate what is now \$500,000 worth of employer stock. Upon taking your lump-sum distribution, you would pay taxes only on the \$50,000 you *paid* for that stock. In “nerd-speak,” the other \$450,000 is so-called Net Unrealized Appreciation and it is subject to favorable long-term capital gains rates (which are currently capped at 15% through 2010) and that tax is imposed only when you actually sell the stock – if ever.

In allowing this break, the IRS does impose a number of rules. While the rules are not onerous, the IRS has been regimented in their application. In evaluating your options, seek qualified counsel.

Glenn Wessel is a CPA, a Chartered Financial Analyst charterholder, and a Certified Financial PlannerTM practitioner. He operates a fee-only investment counsel practice in Asheville, North Carolina.