NUA – TRIGGER ACTIVATORS!

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The goal of the net unrealized appreciation (NUA) tax strategy is to enable a person to pay taxes on the appreciation of company stock formerly in a work plan at long term capital gain rates as opposed to ordinary income rates. The spread between long term capital gains vs. ordinary income could result in a sizable tax savings for those eligible for the strategy. However, not everyone can participate, and for those who are candidates for NUA, there are potential stumbling blocks along the way.

Without getting too deep into the NUA weeds, if a person has significant appreciation in company stock held in a workplace plan like a 401(k), and if that person hits a particular trigger event, then NUA could be in the cards. (Note that "significant appreciation" is subjective.) Those trigger event are turning age 59 ½, separation from service (not for the self-employed); disability (only for the self-employed), and death.

Once a trigger is hit, an imaginary "NUA eligibility light" is turned on. The account holder does not have to proceed with the NUA strategy immediately. The light will stay on until the trigger is activated. This is where account owners need to tread carefully. A wrong turn or innocent transaction could unintentionally activate the trigger. And if the activated trigger is not addressed by year end, it will be forever lost.

As 2022 comes to a close, it is vitally important for anyone considering the NUA tax strategy who has hit a trigger event to determine whether they have activated that trigger with any subsequent transaction. Here are a few common "trigger activators" that will start your NUA light to flash and require immediate attention if you wish to capitalize on NUA this year.

In-Service Distributions. Do you have access to in-service distributions from your work plan? If you hit an NUA trigger and were planning on leveraging the strategy at some point in the future, a subsequent in-service distribution will activate the trigger and require the NUA process to be completed in that same calendar year. Did you take a distribution to fund a family vacation? To buy a boat? To do anything at all? If so, your NUA trigger will be activated and flashing.

Required Minimum Distributions (RMDs). If you hit an NUA trigger a few years ago and made a concerted effort to avoid activation until you were ready to move forward with the NUA strategy – good for you! But now you are 72. Did the plan automatically send you your first RMD? Trigger activated! Time to act!

72(t) Distributions. Have you been taking consistent 72(t) payments from your work plan? (While rare from a plan, they do exist.) Like RMDs and in-service distributions, 72(t) payments from a plan will activate an NUA trigger just the same.

In-Plan Roth Conversions. Yes, even in-plan Roth conversions can activate an NUA trigger.

For anyone who has hit a trigger event and intends to leverage NUA in a future year, it is imperative to ensure your trigger has not been inadvertently activated. Otherwise, if you fail to act immediately, the trigger (and NUA tax strategy) could be squandered.