carver financial services INC.
Established 1990
An Independent Advisory Firm

CLIENT MEMO

'PERSONAL VISION PLANNING™ SINCE 1990'

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WELCOME!

Welcome to our spring 2017 Client memo. 2016 gave us a 24/7 news cycle focused largely on the election and 2017 is off to an interesting start. We are deluged with confusing, and often conflicting information, that is often incomplete or simply wrong. We expect to hear more about the new DOL rule, income tax changes and other potential issues and opportunities this year. Our mission is to make your life better. We are here to help you achieve your personal goals and vision whatever they may be. Part of this is sorting through all of the hype to focus on what is relevant to you. The more we know specifically about what is important to you the more we can help you achieve your personal vision. We take a holistic approach to planning that looks beyond just investments to what is important personally, your tax situation, estate planning and even vacation plans. Your portfolio and investments, in our opinion, are just tools for achieving your vision.

There are many advisors that sell or manage investments. Our team is not one of them. The portfolio or market return is not nearly as important, as making sure you can do what you want to do in life when you want to do it. Similarly the gross return on your portfolio is not important – what you keep net of taxes, fees and expenses is. While many advisors focus on a gross return, our advisors look at helping to get the best net return for you. It's not what you make that counts – it's what you keep! This may sound different and that's because it is. We are focused on providing a great experience for you beyond just planning and hope you take advantage of the many events and opportunities we provide.

As with many things in life what you get out of our partnership will be proportionate to how much you participate. We offer a wide range of experiences and services for you and your family ranging from special speakers to client trips. From helping you minimize your income tax currently to helping to achieve specific estate planning and philanthropic goals in the future. Events such as our David Rutherford presentation in March supplement our personal meetings and conversations. The newsletter summarizes some of what is coming up and you can always check out our website for more information.

We have continued to add new technology and new team members to provide a personal and human review and monitoring of your planning. While many advisors are moving to automated investment planning and general models we remain committed to a customized approach based on speaking with you personally. We have added two new team members in the first quarter of 2017 one of whom we introduce here. We continue to be very selective in taking on new clients so we can continue to provide the utmost attention to those who are part of our community now. We are happy to speak with family and friends without cost or obligation if you feel we can assist them.

Markets will go up and down, political parties will fall in and out of favor and the media will continue to try and scare us. Whatever happens we are here for you. Please contact us with questions, concerns or whenever we can be of service. We look forward to speaking with you soon and seeing you at some of our upcoming events. This is an exciting time and we appreciate the opportunity to share the journey with you as your partner.

Respectfully,

Randy Carver, President Carver Financial Services Inc./RJFS Registered Principal

Please Send Us Your Tax Returns

While we are not Certified Public Accountants (CPAs), we oftentimes work closely with these professionals to provide coordinated advice that can often lead to reduced tax liability for many of our clients. We are very familiar with the tax code and our recommendations are always provided with tax implications in mind. Remember—it is not what you make, but what you keep that matters. Improperly managing the tax efficiency of your investments can have a dramatic impact come tax time.

We live in a world where taxes are inevitable, but we also have various tools and opportunities that we can proactively use to help minimize this expense. Simple strategies such as paying real estate taxes and an extra mortgage payment before year end can sometimes lead to additional benefits simply based on manipulating the timing of the payments by a few days at the end of a calendar year. Other opportunities such as Health Savings Accounts (HSAs) are options that many people are eligible for but may not fully take advantage of.

Many clients provide us with copies of their completed individual tax returns (Form 1040) each year and this information can lead to further discussions to help reduce their tax burden. Often these discussions evolve to include your CPA or tax preparer. We are firm believers that our best advice is given when we have as much information as possible regarding our client's financial situation. As you have your 2016 tax return prepared, please send or bring in a copy that we can include with your file for future meetings.

A Client's Friend and Referral

A great client came in and said she was speaking to a friend who asked her what the team at Carver Financial Services Inc. does for her. Our client indicated that as she got into the discussion she realized that our role was not helping her with her investments but really managing her life. She was then asked what this cost and when she really dug into it found that it was far less than her friend was paying simply to buy and sell investments.

Our mission is to make people's lives better. We view investments simply as one tool for doing this. The key to successful vison planning is taking a holistic approach to meeting your goals. Many advisors sell investments and may ask some general questions about what you are doing. We do not believe that this truly benefits you. Our goal is to understand what you want to do with your life now and in the future, and then help you achieve this vision. Interestingly in many cases our clients do not really know what they want the future to look like, this is another place our advisors can help you. If you really do not know where you want to go, it is hard to select appropriate vehicles and routes to get there.

Once we've determined what your personal goals are, we then develop a plan to help you achieve the goal. While people and firms develop financial plans they then move on to other things. We believe that your plan is a living and evolving process. We speak with you regularly to understand your changing needs and goals and adjust your planning based on these changes. We also monitor your portfolio considering changes to tax laws, market conditions and individual investments and proactively contact you should a change be needed. This was very different from what our client's friend was doing where they simply bought investments and were pitched new ones periodically.

We generally work on a flat fee basis, rather than commission basis. We believe that this provides the most investment flexibility and transparency of expense while minimizing the overall cost to you. In many cases the fee is tax deductible as an itemized expense further reducing the net cost; whereas commissions are not deductible. This also aligns our interests. If your assets grow we both benefit, if they do not our fees go down or the client may leave. We do not have upfront fees or penalties to leave nor do we charge any retainer or planning fee. With all fee based accounts we are considered a fiduciary where the clients interest must be put first. Advisors at other firms that work on a commission basis are not held to this standard – they can put their own interest first as long as the investment is "suitable".

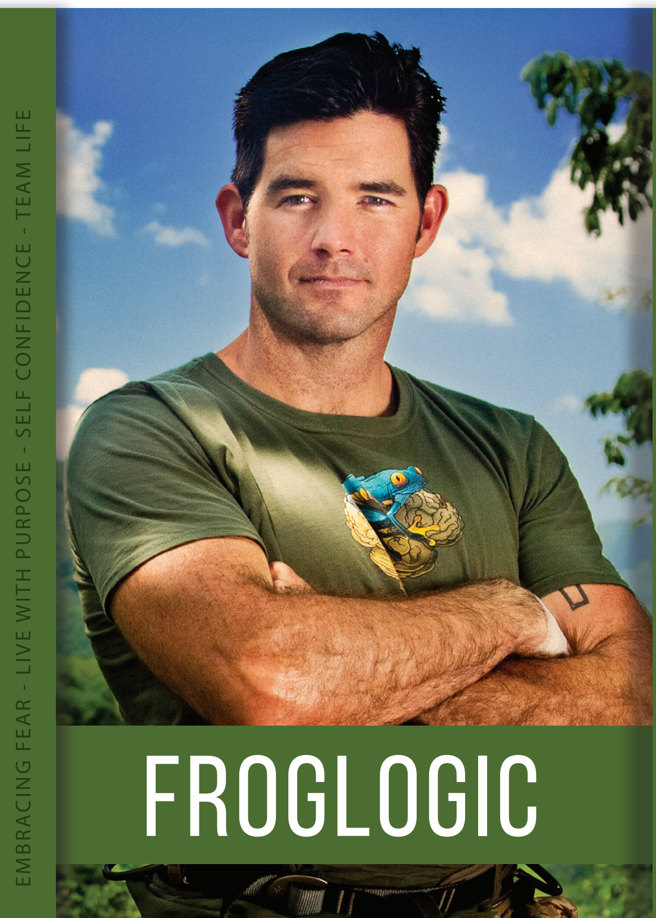
Our client then went on to explain to her friend how we work as a team. This means that she has access to someone whenever she wishes and that Carver Financial Services Inc. will be here for generations to come. Her friend commented how her advisor had changed firms several times and that she was worried if something happened to him she would have to start over.

Our client then asked if we would speak to her friend and if we had an investment minimum. We explained that we will speak to any referral without cost or obligation. We are happy to provide a second opinion on an existing plan or help someone create a new one. This is a partnership so it's important that we are the right fit for a prospective client and they are a good fit for us. By meeting, at least by phone, we can see if there is a good fit and then take it from there. We will provide a written summary of our recommendations, what the next steps would be and what the fee would be to work with us.

We generally have an investment minimum of $500,000 but waive this for family members of existing clients or someone who expects to meet the minimum in the next year. The advisory fee will depend on the assets being invested but generally ranges from 0.60% to 1.25% - each case being unique. We do not use any model portfolios but utilize a customized approach for each client. Some advisors likely use a series of models which they put everyone into, without consideration for income tax or estate planning. We believe in a holistic approach that takes into account these and other factors. After all it's not what you earn that's important but how much you keep!

Our client also explained to her friend that we hold various events though out the year focusing on personal development and updates on current events. Her friend was surprised as her current firm doesn't do any events and in fact rarely spoke to her other than when they wanted to sell her something.

Our team and the service we provide are not for everyone. We are happy to speak to any friends, family or business associates that you feel we can help without any cost or obligation. If we are not the right fit, we can generally refer them to someone who is. Our goal is to help them and where appropriate develop a long term relationship. If you refer someone please have them let us know that when they contact our office. People can meet with any advisor or make a specific request. Please note that we do work as a team and so when people come in they may meet with several people so we can best assess if there is a good fit and how we can best serve them. Please contact your advisor if you have any questions about someone you feel we can help, or if we can otherwise be of service.



A SPECIAL EVENT WITH NAVY SEAL
DAVID RUTHERFORD

WEDNESDAY MARCH 29, 2017

You are invited to join us for a very special event with David Rutherford. A former Navy SEAL Medic & Instructor. David is an internationally known Motivational Speaker, bestselling author for adults and kids, performance coach, podcast post, YouTube personality, and Tactical Training Expert.

David's Froglogic – Navy SEAL Motivational Training program has reached over 4 million people around the world. His passion for teaching is founded in helping people learn to embrace their fears, forge their personal and professional *Self Confidence*, commit to living a team oriented lifestyle and to discover a long term purpose for living. David's high energy, high impact style of speaking and coaching inspires all those who come in contact with him to defeat the Negative Insurgency in their lives and to live life to its fullest.

2 Times: Breakfast 8:30 AM or Evening Pasta Bar 7:00 PM
LaMalfa Center | 5783 Heisley Rd., Mentor, OH 44060

You are encouraged to invite family and friends and especially children to this very special event. There is neither a cost nor any obligation; however, due to limited space reservations are requested. **To RSVP please contact our office (440) 974-0808.** Reservations will be taken on a first come first served basis!

**David Rutherford is not affiliated with Raymond James*

Key Retirement and Tax Numbers for 2017

Every year, the Internal Revenue Service announces cost-of-living adjustments that affect contribution limits for retirement plans, thresholds for deductions & credits, and standard deduction & personal exemption amounts. Here are a few of the key adjustments for 2017.

Retirement plans

Employees who participate in 401(k), 403(b), and most 457 plans can defer up to $18,000 in compensation in 2017 (the same as in 2016); employees age 50 and older can defer up to an additional $6,000 in 2017 (the same as in 2016).

Employees participating in a SIMPLE retirement plan can defer up to $12,500 in 2017 (the same as in 2016), and employees age 50 and older will be able to defer up to an additional $3,000 in 2017 (the same as in 2016).

IRAs

The limit on annual contributions to an IRA remains unchanged at $5,500 in 2017, with individuals age 50 & older able to contribute an additional $1,000. For individuals who are covered by a workplace retirement plan, the deduction for contributions to a traditional IRA is phased out for the following modified adjusted gross income (AGI) ranges:

	2016	2017
Single/head of household (HOH)	$61,000 - $71,000	$62,000 - $72,000
Married filing jointly (MFJ)	$98,000 - $118,000	$99,000 - $119,000
Married filing separately (MFS)	$0 - $10,000	$0 - $10,000

Note: *The 2017 phaseout range is $186,000 - $196,000 (up from $184,000 - $194,000 in 2016) when the individual making the IRA contribution is not covered by a workplace retirement plan but is filing jointly with a spouse who is covered.*

The modified AGI phaseout ranges for individuals making contributions to a Roth IRA are:

	2016	2017
Single/(HOH)	$117,000 - $132,000	$118,000 - $133,000
(MFJ)	$184,000 - $194,000	$186,000 - $196,000
(MFS)	$0 - $10,000	$0 - $10,000

Estate and gift tax

The annual gift tax exclusion remains at $14,000.
The gift and estate tax basic exclusion amount for 2017 is $5,490,000, up from $5,450,000 in 2016.

Personal Exemption

The personal exemption amount remains at $4,050. For 2017, personal exemptions begin to phase out once AGI exceeds $261,500 (single), $287,650 (HOH), $313,800 (MFJ), or $156,900 (MFS).

Note: *These same AGI thresholds apply in determining if itemized deductions may be limited. The corresponding 2016 threshold amounts were $259,400 (single), $285,350 (HOH), $311,300 (MFJ), and $155,650 (MFS).*

Standard deduction

These amount have been adjusted as follows:

	2016	2017
Single	$6,300	$6,350
HOH	$9,300	$9,350
MFJ	$12,600	$12,700
MFS	$6,300	$6,350

Note: *The 2016 and 2017 additional standard deduction amount (age 65 or older, or blind) is $1,550 for single/HOH or $1,250 for all other filing statuses. Special rules apply if you can be claimed as a dependent by another taxpayer.*

Alternative minimum tax (AMT)

AMT amounts have been adjusted as follows:

	2016	2017
Maximum AMT exemption amount		
Single/HOH	$53,900	$54,300
MFJ	$83,800	$84,500
MFS	$41,900	$42,250
Exemption phaseout threshold		
Single/HOH	$119,700	$120,700
MFJ	$159,700	$160,900
MFS	$79,850	$80,450
26% on AMTI* up to this amount, 28% on AMTI above this amount		
MFS	$93,150	$93,900
All others	$186,300	$187,800
*Alternative minimum taxable income		

Tax Forms and Filing – It's tax time again!

While we recommend you do your income tax preparation as soon as you receive all tax documents, we strongly recommend waiting to file your tax return until April and consider filing for an extension in the event corrected documents come in at the last minute. If you file and then delayed documents come in you will need to re-file an amended return. We also recommend using a qualified CPA for your tax preparation. Because of delayed legislation we expect even more delays in reporting this year. Raymond James does everything it can to get out the information in a timely and accurate fashion.

Please note the following dates that you can expect tax reporting forms:

• Because there are often last minute corrections and delays many companies will not be mailing the first round of 1099's until February this year. The first round of 1099's is expected to be sent between February 15th – 28th, 2017. What the IRS terms 'delayed 1099s' will not be sent until March 14th.

All tax documents will be available via the Investor Access online system as soon as they are generated. You may also give your CPA access to these electronic documents by setting up a Third Party Investor Access – Our assistants can help you set up Investor Access and third party access if you wish to do so.

Last tax season, mailing of many 1099s was delayed. Raymond James first mailing of original 1099 tax forms occurred on February 15 and all original 1099s with cost basis related activity were delayed until March 15. These delays affected many clients. To rectify this Raymond James has told us they will be mailing 1099s as soon as they receive information from investment companies.

It is imperative to remember that certain investment types are prone to income reallocation. The IRS understands that these reallocations frequently result in delayed or amended 1099s and it grants reporting extensions for clients who hold these types of investments. Please note the following:

• Widely Held Fixed Investment Trusts (WHFITs) - Under the IRS definition, the affected market segments include Unit Investment Trusts (UITs), Royalty Trusts, Commodity Trusts, and Mortgage Pools such as Fannie Mae. Trustees and middlemen of WHFITs are required to report all items of gross income and proceeds on the appropriate Form 1099. The reporting deadline for these items is March 16th so you may receive a delayed 1099 (early April) if you own these types of investments.

• If you receive a 1099-B, please keep in mind that you are responsible for reporting the gain/loss on what you sold, not the entire amount. This means that you are responsible for the difference between what you originally paid for it and what you sold it for. We will provide cost basis information on holdings that we have the data for. If you have transferred an asset in or cost basis is not showing on your statement please call our office.

• You may receive a W9 form from your mutual fund and annuity companies. These are used to confirm and/or update your social security number. If you receive a W9 you simply need to fill in your social security number, sign and return to the Vendor. These are mailed as a matter of routine every few years

• You may receive a 1099 for non-taxable transactions such as an IRA rollover or 1035 exchange of an annuity. A 1035 exchange is reported as Code '6' in box 7; a direct rollover to an IRA is reported as code 'G' in box 7; and a direct rollover to a qualified plan or TSA is reported as Code 'H' in Box 7. Receiving one of these 1099's does not mean that taxes are owed but you should carefully follow the IRS instructions for reporting this transaction.

• K-1 forms are issued by partnerships, S-corporations, trusts and estates to report a taxpayer's pro-rated share of net income or loss from the entity, along with various separately stated income and deduction items. These forms are required to be sent by the first March 15 following the close of the partnership's tax year and therefore investors may not receive their K1 until late March or even the first week of April.

Should you have a question pertaining to your tax documents please give us a call. The area of tax law is very complex. Extreme care must be used in developing accurate tax information. Both our office and the Raymond James 1099 Tax Reporting Department can answer many of your questions; however, we are not accountants and cannot provide specific tax or legal advice. We can recommend a qualified Certified Public Account (CPA) should you need assistance in preparing your taxes. You can also get answers to many of your questions using free IRS Publications which can be obtained by calling 1-800-TAX-FORM (1-800-829-3676) or by visiting the IRS website at www.irs.ustreas.gov where you may also print tax forms.

Please note that since 2005, the IRS has outsourced collection work to private agencies, thus allowing the IRS to focus on more complex tax cases. The amount of individual uncollected tax revenue (i.e., from Form 1040s) is estimated to be $13 billion. The government will pay as much as 25% of the debts collected to the private collection agencies as compensation for their services (source: Treasury Department). The bottom line is that it is important to have accurate and complete tax returns. We recommend working with a tax professional in this regard. It is also important to note that the IRS never demands payment or personal information over the phone or by credit card. Any such phone call is most likely a scam. The IRS will contact you in writing if there are any questions or issues.

Should I Consolidate?

We still hear the question "Is it safe to keep all of my assets with one company, such as Raymond James?" a few times throughout the year. The underlying concern seems to be that if Raymond James were to go out of business, that all of your investments could disappear with it. We understand this natural concern; however, it is important to remember that Raymond James doesn't generally hold the investments that are in your account. The investments are held at the issuing company and Raymond James simply consolidates the recordkeeping within one convenient platform for you to view your holdings. Moreover, there are a number of reasons consolidating your investments may be very advantageous for you.

These advantages include, but are not limited to:

- Simplified recordkeeping and tax reporting. You receive a single consolidated 1099 at year end rather than multi tax reports from different firms. The online Investor Access will also allow you to authorize your tax preparer to review and monitor all tax information in real time. Consolidated account statements also save you time by giving you a complete and accurate view of your entire portfolio via one hard copy statement and/or electronic access rather than having to go through a number of different sources.
- Analyzing your entire portfolio allows your advisor to likely provide more comprehensive investment, estate planning, and tax management recommendations.
- Access to the full portfolio allows your advisor to monitor the underlying holdings within the various funds you own which can reduce investment overlap, concentration and redundancies.
- Larger consolidated balances can qualify you for lower management and advisory fees based on household relationship size.
- A consolidated account can simplify your estate planning, monitoring and ultimately the transfer to your heirs.

Please note there may be some assets we may be unable to transfer, such as your current employer's 401(k) and/or 403(b) or a private placement investment. It is still important for you to discuss these with your financial advisor so that we can make the best recommendations possible based on your overall situation. Similar to when you visit your doctor – you provide the professional with an updated list of the medications you're on so that he/she doesn't run the risk of prescribing you something new that may have an adverse reaction with your current medications. If your doctor does not have a full understanding of your situation they cannot effectively help you. Please contact your advisor to discuss consolidating accounts and/or for a second opinion on any outside holdings.

MEET OUR NEWEST TEAM MEMBER

Lindsay Necci, *Client Service Associate*

We continue to grow our team with experienced professionals who are committed to our mission of making peoples lives' better. Our newest addition is Lindsay Necci.

Lindsay joined the Carver team January 2017 as a Client Service Associate. She graduated from Baldwin-Wallace College in 2005 with a Bachelor of Science in Business Administration and currently holds licenses series 6 and 63 as well as a life, health, and annuity insurance license. Lindsay has 9 years in the financial industry primarily focusing in private banking. She grew up in Willowick and currently resides in Mentor with her husband Tony and their two sons, Anthony and Ilario. Outside the office Lindsay loves spending time with her family at the park, camping, and traveling to Arizona to visit relatives.

Amazing Experiences In 2017 For You, Family And Friends

We will be hosting a number of exciting and unique events in 2017 - you can find more details and info on some more events on our website **www.carverfinancialservices.com**. There is no cost to attend any of the following and you are welcome to invite family and friends. Reservations are requested due to limited space.

03.29.17 Navy SEAL David Rutherford | 8:30 am or 7:00 pm
Navy SEAL Medic & Instructor - Top Motivational Speaker, Best-selling Author, performance Coach, Podcast Host, YouTube Personality, and Tactical Training Expert. David's Froglogic training has reached over 4 million people around the world. His Froglogic Concepts are derived from combining his 25 years of exploring and researching the human condition with over 70 plus years of operational successes within the UDT/ Navy SEAL Teams. A great event to bring children and teens to!

05.17.17 Transition to Retirement | 7:00 pm
A town hall meeting discussing considerations as you transition into retirement. *Topics to include: Taking a lump sum vs. pension, Tax efficient distributions, Healthcare expense in retirement, Tax free and guaranteed income in retirement, What else should I be thinking about.*

06.19.17 Annual Charity Golf Outing
We will once again be returning to Fowlers Mill for a great day of golf and helping others. We already have commitments for amazing prizes and have a discount for early registration. The day includes lunch, dinner, golf and prizes- $110 per person or $400 for foursome if registered before April 20th – then $135 per person or $500 per foursome after April 20th.

08.05.17 Annual Wings & Wheels Car and Aviation Show

08.18.17 Annual Client Appreciation Event with the Captains

10.18.17 Songwriter Concert & Experience | 7:00 pm
This is a concert experience like none-other. We are hosting two award winning singer songwriters. Details will be announced this summer!

New DOL Rule and IRAs

On April 6, 2016 the Department of Labor (DOL) announced a new rule related to fiduciary responsibility for retirement accounts. The new rule will mandate that Individual Retirement Accounts (IRAs) to be covered by ERISA, similar to most employer sponsored retirement plans such as your 401(k). This may have a large impact on individuals with IRA's and the financial services industry. The new rule is scheduled to be effective April 10, 2017 and we expect that you will hear more about this as we get closer to that date. There has not been a lot of discussion on this as the news cycle seems to be filled with election coverage. Some have said that this is the biggest change to the financial services industry in more than 50 years and we do expect more attention as we get closer to April. As has been customary with incoming administrations when control of the White House has changed parties, the Trump administration has directed federal agencies to: *"Delay by 60 days the effective date of final regulations that have already been published but have not yet taken effect and, to re-open the comment period for these regulations."* So we will have to see what ultimately happens. We believe that over the next year there will be regulation enacted to increase the transparency of investment expenses and to try to eliminate conflicts of interest between clients and the firms providing investments and advice.

Until the rule goes into effect those licensed to give financial advice are only required to act on a "suitability standard" for a client's IRA, as opposed to acting on a "fiduciary standard". A suitability standard does not require the advisor to make recommendations that are necessarily in the client's best interest; rather it only requires that they choose investments that are suitable. A troublesome issue with the suitability standard is that it does not require the advisor to disclose any conflicts of interest. This means that the advisor could potentially recommend their firm's proprietary products, resulting in a higher commission to them, even though said products may be more expensive to the client than other options available. There has also been little guidance on the disclosure of fees or expense prior to this rule.

Under a fiduciary standard, advisors are required to disclose any such conflicts and put their client's best interests ahead of their own. The professionals at Carver Financial Services Inc. have always worked in our clients' best interest and do not offer any proprietary products. We have always fully disclosed all fees and expenses associated with accounts. Accounts set up on a fee basis have always been held to the fiduciary standard from a regulatory standpoint and we have always put our clients' interests first. Many of our team members hold CERTIFIED FINANCIAL PLANNER™ designation, which has also always required them to act on the fiduciary standard, the highest legal standard of devotion in the industry. We are pleased to see that this rule will raise the bar for the industry as a whole.

While it is likely you will hear much about the impact of the new rules and many firms may be affected we do not foresee this negatively impacting our clients. The media will most likely focus on the negative and sensational. We view this rule potentially having the same impact on the financial services industry as the Affordable Health Care Act (aka Obamacare) had on the medical and insurance industries. The intention was good – but the execution resulted in higher cost and more complexity for many.

Some major firms are terminating client accounts that fall below of a minimum of $100,000 - $250,000 – we are NOT firing any existing clients. Some firms are limiting what clients can invest in – we are not doing so.

We will proactively work with you to comply with any required changes and will continue as always to put your interest first. We expect to hear more about the rule in the coming months and will continue to update you on all developments. As with anything please contact your advisor if you have any questions or concerns. We appreciate the opportunity to serve you and provide the best experience possible.

A Unique Opportunity If You Own Company Stock
- Net Unrealized Appreciation

If you participate in a 401(k), ESOP, or other qualified retirement plan that lets you invest in your employer's stock, you need to know about net unrealized appreciation--a simple tax deferral opportunity that may provide a big tax benefit.

When you receive a distribution from your employer's retirement plan, the distribution is generally taxable to you at ordinary income tax rates. A common way of avoiding immediate taxation is to make a tax-free rollover to a traditional IRA. However, when you ultimately receive distributions from the IRA, they'll also be taxed at ordinary income tax rates. (Special rules apply to Roth and other after-tax contributions that are generally tax free when distributed.)

But if your distribution includes employer stock (or other employer securities), you may have another option -- you may be able to defer paying tax on the portion of your distribution that represents net unrealized appreciation (NUA). You won't be taxed on the NUA until you sell the stock. **What's more, the NUA will be taxed at long-term capital gains rates -- typically much lower than ordinary income tax rates.** This strategy can often result in significant tax savings.

What is net unrealized appreciation?

A distribution of employer stock consists of two parts: (1) the cost basis (that is, the value of the stock when it was contributed to, or purchased by, your plan) and (2) any increase in value over the cost basis until the date the stock is distributed to you. This increase in value over basis, fixed at the time the stock is distributed in-kind to you, is the NUA.

For example, assume you retire and receive a distribution of employer stock worth $500,000 from your 401(k) plan, and that the cost basis in the stock is $50,000. The $450,000 gain is NUA.

How does the NUA tax strategy work?

At the time you receive a lump-sum distribution that includes employer stock, you'll pay ordinary income tax only on the cost basis in the employer securities. You won't pay any tax on the NUA until you sell the securities. At that time the NUA is taxed at long-term capital gain rates, no matter how long you've held the securities outside of the plan (even if only for a single day). Any appreciation at the time of sale in excess of your NUA is taxed as either short-term or long-term capital gain, depending on how long you've held the stock outside the plan.

Using the example above, you would pay ordinary income tax on $50,000, the cost basis, when you receive your lump-sum distribution. (You may also be subject to a 10% early distribution penalty if you're not age 55 or disabled when you receive the payment.) Let's say you sell the stock after ten years, when it's worth $750,000. At that time, you'll pay long-term capital gains tax on your NUA ($450,000). You'll also pay long-term capital gains tax on the additional appreciation ($250,000), since you held the stock for more than one year. Note that since you've already paid tax on the $50,000 cost basis, you won't pay tax on that amount again when you sell the stock.

If your distribution includes cash in addition to the stock, you can either roll the cash over to an IRA or take it as a taxable distribution. And you don't have to use the NUA strategy for all of your employer stock-- you can roll a portion over to an IRA and apply NUA tax treatment to the rest.

In general, you're only allowed to use these favorable NUA tax rules if you receive the employer securities as part of a lump-sum distribution. To qualify as a lump-sum distribution, both of the following conditions must be satisfied:
• It must be a distribution of your entire balance, within a single tax year, from all of your employer's qualified plans of the same type (that is, all pension plans, all profit-sharing plans, or all stock bonus plans)
• The distribution must be paid after you reach age 59½, or as a result of your separation from service (if you're an employee), disability (if you're self-employed), or death

There is one exception: Even if your distribution doesn't qualify as a lump-sum distribution, any securities distributed from the plan that were purchased with your after-tax contributions will be eligible for NUA tax treatment. (After-tax contributions for this purpose do not include your Roth 401(k) contributions.)

It is important to note that once you do a rollover to your IRA you lose the opportunity to take advantage of the NUA strategy. Stock must come directly from the 401(k) or ESOP to you.

What are some of the advantages of NUA treatment?

• Your distribution of NUA will be taxed at long-term capital gains rates, rather than ordinary income tax rates. Long-term capital gains rates are generally much more favorable, and currently are as low as 0% for some taxpayers.
• Your distribution won't be subject to the required minimum distribution rules that would apply if you rolled the distribution over to an IRA. You need never sell the stock if you don't want to.
• The NUA portion of your distribution will never be subject to the 10% early distribution penalty tax.

What are the disadvantages of NUA treatment?
• Your cost basis in the stock is subject to tax at ordinary income tax rates when the stock is distributed to you. A 10% early distribution penalty tax may also apply if you're not age 55 or disabled when you receive your payment. (The 10% penalty tax generally doesn't apply if you're self-employed.)
• You'll lose the benefit of tax-deferred growth offered by a rollover IRA.
• NUA treatment applies only to employer stock and other securities. But holding a significant amount of employer stock may not be appropriate for everyone. In some cases, it may make sense to diversify your investments.

Please contact us to discuss this strategy and see if it may make sense for you.

The above is a hypothetical example for illustration purpose only and does not represent an actual investment