



## Do you own stock in your 401(k) account? If so, you may be interested in a story of how a client was able to maximize his retirement and charitable giving while minimizing taxes.

The story begins in January of 2000. "Tom" accepted a job with the Sherwin-Williams Corporation earning a \$100,000 salary. At that time, he made the decision to contribute 6% of his pay to his 401(k), which earned him a 4% match from the company. Not knowing much about how to choose investments, and having heard a lot of good things about the company's stock, he decided to "just" put 80% of his contributions into one of the better performing mutual funds in the plan, while using the remaining 20% to buy shares of Sherwin stock.

The fund that he chose was the Fidelity® Contrafund, which had performed extremely well through the Dotcom bubble of the late 90s. Over a 23-year period, he didn't change his allocation, instead letting it ride. In April of 2023, Tom made the decision to retire at age 60, at which time his 401(k) had accumulated to \$1.8 million in value—approximately \$1.05M in Contrafund, and \$763,000 in Sherwin stock.

Given the average annual return of over 18%\* that he'd been receiving from the Sherwin-Williams stock (just under \$65,000 had been used to buy the shares over time), Tom had grown quite fond of it. When he met with me, he said that he wanted to maintain his holdings in the 401(k) plan in order to minimize fees.

Instead of accepting what Tom wanted to do, I proactively shared a strategy that Tom had never heard of. I advised him to roll over the proceeds from the Contrafund into an IRA, and at the same time transfer his Sherwin-Williams stock shares into a non-retirement brokerage account, where he could potentially never pay taxes on the approximately \$710,000 of growth he had received so far (1).

In other words, I introduced Tom to the Net Unrealized Appreciation Strategy (2). To use this strategy, Tom was required to remove all assets from any retirement plan that he had at Sherwin. This included the Pension plan that the company had contributed to on his behalf for many years as well. All assets aside from company stock were rolled over into an IRA. The Stock was distributed "in kind" from the 401(k) provider to a non-qualified brokerage account. At the end of the year, he was issued a 1099-R, which reported the Net Unrealized Appreciation amount in Box 6.

Tom worked with myself and his accountant to determine the cost of doing this, knowing that the IRS would require him to pay Income taxes on the \$65,000 of contributions in the same year that he transferred the shares out. This tax initially made Tom hesitant to use the strategy, knowing it could cost him over \$14,000 in Federal Income taxes for that year in his 22% tax bracket. However, we discussed that if he strategized by holding on to the stock and living off its dividends, and then left the stock to his children, he could potentially save \$145,000 in taxes in the long run by avoiding income tax on unrealized appreciation (3).

Tom was also hesitant to continue to hold so much of his retirement assets in one company stock. What if it went under, or declined substantially in value? I helped him make the prudent decision to set a limit of keeping 10% of his retirement assets in the stock.

Ultimately, Tom decided to transfer \$170,000 of the stock in kind, while diversifying the remaining amount. Unfortunately, Sherwin did not allow him to pick specific shares to transfer out of the stock, instead requiring him to do so pro-rata. (In an ideal scenario, he would have been able to choose only the shares with the lowest cost per share and the most growth.)

Before proceeding with the transfer, Tom and I discussed his desire to be charitable throughout his retirement, which uncovered one more opportunity. I suggested that he consider contributing stock to a donor-advised fund which would allow him to take highly appreciated stock that he had owned for at least one year and diversify out of it without having to pay capital gains taxes on the growth. Tom would have to give up ownership of the funds, but would still have control over which charities they were donated to.

Tom shared that he planned to donate \$10,000 annually, so I suggested taking an additional \$66,000 of Sherwin stock out of the plan to contribute to the [Donor Advised Fund](#) over the next six or seven years. In doing so, he would be able to take a tax deduction <sup>(4)</sup> for the same amount, and potentially reduce or eliminate tax on the cost basis.

The Net Unrealized Appreciation strategy is not right for everyone, and there are many instances in which it may not make sense; however, its value can be great. If the strategy is not completed correctly, it can be disallowed by the IRS, leaving a much larger tax bill than expected. Therefore, anyone considering this strategy is strongly encouraged to seek the counsel of a tax professional with experience utilizing this strategy.

## Do you own company stock in your 401(k)?

Taking an in-kind distribution of your company's stock from your 401(k) and contributing it to a taxable investment account could reduce the taxes you pay on it over your lifetime. [Click here](#) to see whether this option could benefit your retirement savings.

### Disclosure:

The situation presented in this scenario is not specific to any certain client scenario but has been based upon experience with many clients and is fictitious in nature. Please note this example may not be suitable for all, and you should check with your financial planner about your specific situation. The information provided is for educational and informational purposes only and does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your attorney, tax advisor, and/or your financial professional prior to making changes to your portfolio or strategy. The views expressed in this commentary are subject to change based on market and other conditions. These documents may contain certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected. Any projections, market outlooks, or estimates are based upon certain assumptions and should not be construed as indicative of actual events that will occur. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. All investments include a risk of loss that clients should be prepared to bear. The principal risks of our strategies are disclosed in the publicly available Form ADV Part 2A.

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<sup>1</sup>See IRS publication 551 "Basis of Assets"

<sup>2</sup>See IRS publication 575 "Pension and Annuity Income"

<sup>3</sup>\$660,000x.22=\$145,000. See IRS publication 551 "Basis of Assets" for step up in basis received on inherited stock shares

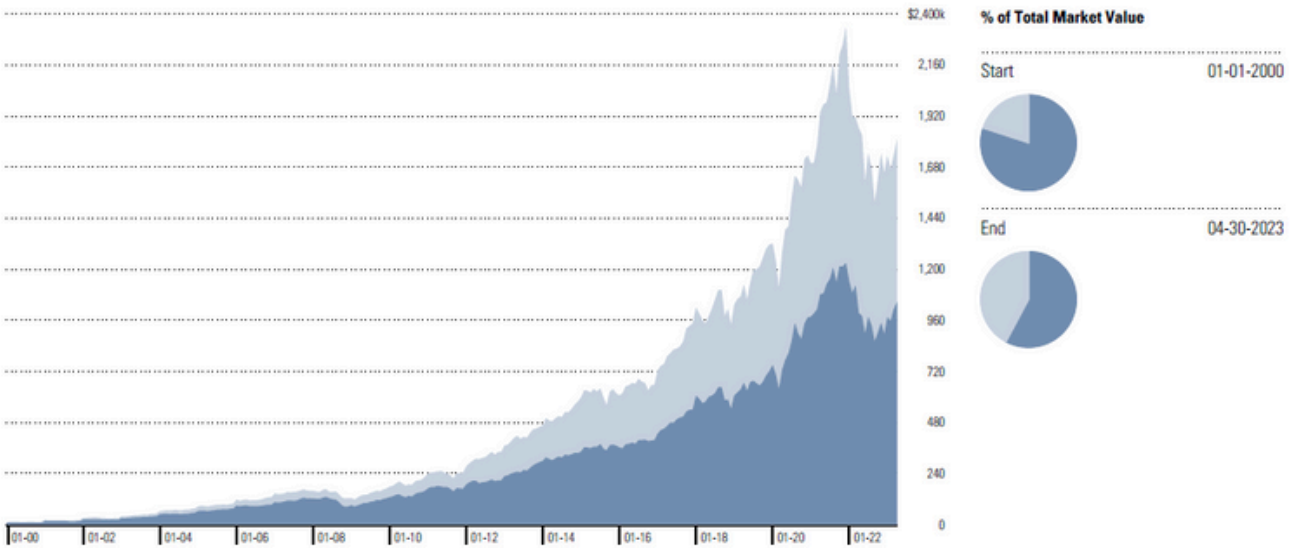
<sup>4</sup>See Charitable Contribution Deductions on the IRS's Website

\*See attached Morningstar Illustration

# Hypothetical Portfolio Illustration Continued : (Brokerage)

01-01-2000 to 04-30-2023

## Security Summary



## Investment Assumptions

Investment Name	Holding Period		Initial Investment Amount	Subsequent Invest/Withdwl		Reinvest Distributions		Liqui-date	Re-balance (%)	Charges and Fees			Market Value End (\$)	
	Start	End		Amount	Amount	Freq	Income			Cap Gains	Front Load	Annual Fee		Deferred Load Amount%
● Fidelity Contrafund (USD, FCNTX)	01-2000	04-2023	0	8,000	Once a Yr	Y	Y	N	—	0.00%	0.00%	0.00-0.00	—	1.05 mil

Stock Name	Holding Period		Initial Investment Amount	Subsequent Invest/Withdwl		Reinvest Distributions		Liqui-date	Re-balance %	Charges and Fees			Market Value End \$	
	Start	End		Amount	Amount	Freq	Income			Cap Gains	Purchase %	Purchase Fee		Annual Fee
● Sherwin-Williams Co (USD, SHW)	01-2000	04-2023	0	2,000	Once a Yr			Y	N	—	0.00	0.00	0.00%	763,454

### Disclosure

The security-level performance data shown represents past performance and does not guarantee future results. The investment return and market value will fluctuate. Current performance and market value will be lower or higher than stated herein. Please refer to the Disclosure Statement and relevant information at the end of the report for additional information.

If shown, the historical benchmark index performance is selected by your financial professional as an appropriate comparison tool and is provided for informational purposes only. Actual performance returns will vary. Please refer to the Benchmark Disclosures for additional information.

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