



Procter & Gamble Profit Sharing Trust (PST) Trustee's Cost: A One Time Shot to Use It or Lose It

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If you plan to retire in the future or have retired from P&G and haven't taken a total distribution from your PST, you still have time to take advantage of a little-known rule in the Internal Revenue Code (IRC) section 402(e) 4. This allows a participant to defer taxes on P&G shares received as a lump-sum distribution and qualify for long-term capital gains tax treatment when the stock is sold in the future.

What is Trustee's Cost?

Throughout your years of employment, P&G has contributed two types of company stock to your PST: preferred shares and common shares. The average cost per share that P&G paid for the stock when contributing to your PST is referred to as *Trustee's Cost*. The average cost varies on both, but the preferred shares have a significantly lower average cost basis, as low as the mid \$6 range, compared to the \$30 range for common shares. One key factor in considering whether to utilize the IRC rule is the *Net Unrealized Appreciation* (NUA) of your P&G stock. NUA is the difference between the current market value of P&G stock and the average Trustee's Cost. Simply put: the more the stock has appreciated, the lower the current tax and the higher the potential tax savings.

How does it work?

When you are eligible to take a distribution from your retirement account, you must complete a lump sum distribution of the entire vested balance within the same tax year. This includes the balance in both the PST and the Savings Plan.

The distribution of company shares must be taken directly from the PST in order to qualify for the Trustee's Cost tax treatment. The NUA strategy can be used on the entire number of preferred and/or common shares, or on just a portion. Any remaining employer stock not elected for NUA treatment can be rolled into a tax-deferred Individual Retirement Account (IRA) along with the remaining balance in the PST and Savings Plan.

In the year of distribution only, the Trustee's Cost portion will be subject to ordinary income taxes. For example, if you withdraw 1,000 shares of stock with a market value of \$65 per share, the total value of the stock will be \$65,000. If the cost basis – the original price of those shares of stock – is \$6 per share, you will pay ordinary income tax on the trustee's purchase price of only \$6,000 (1,000 shares times \$6 per share). If you subsequently sell the shares, the remaining \$59,000 (1,000 shares times the difference between market value and trustee's cost basis) will be taxed at long-term capital gains rates.

Once the NUA rule is utilized, the stock is no longer considered part of the qualified retirement plan. Further, the NUA is not subject to tax until you sell the stock and, even then, it is only subject to long-term capital gains tax rates. Based on current tax rates, this could provide significant tax savings by shifting ordinary income to long-term capital gain income at the time of sale. Currently, ordinary income tax rates are 15% to 35%, while long-term capital gains rates are between 0% and 15%.

Tax Comparison

Ordinary Income Tax and Capital Gains Tax Rates – Married Filing Joint

Taxable Income	Marginal Ordinary Tax Rate	Long Term Capital Gains Tax
< \$65,100	15%	0%
< \$131,450	25%	15%
< \$200,300	28%	15%
< \$357,700	33%	15%
≥ \$357,700	35%	15%

Example:

Assume a married couple filing a joint return takes the standard deduction and requires \$130,000 of annual gross income. In Scenario 1, the income is derived from taking an IRA distribution of \$130,000 subject to ordinary income tax rates. In Scenario 2, the couple took advantage of the Trustee's Cost election, took an IRA distribution of \$65,000 subject to ordinary income tax rates, and sold P&G stock that is now subject to long-term capital gains

tax rates. By utilizing the Trustee's Cost strategy, the couple in Scenario 2 has a federal tax savings of \$8,784.

	Scenario 1	Scenario 2
IRA Income	\$130,000	\$65,000
Capital Gains Income	\$0	\$65,000
Total Income	<u>\$130,000</u>	<u>\$130,000</u>
Total Tax	\$22,100	\$13,316
	<u>NET TAX SAVINGS \$8,784</u>	

Failure to Follow the Rules

The IRS strictly enforces the NUA rules under the Internal Revenue Code Section 402(e) 4. To qualify, you must observe the following rules:

- A lump sum distribution of the entire vested balance in the plan *must* be completed within the same tax year.
- The distribution of company shares on which the NUA tax treatment is elected *must* be taken directly from the retirement plan.
- One of four special events *must* have occurred:
 - Separation from service,
 - Death,
 - Total disability, or
 - Attaining age 59 ½.

Failure to follow these rules will disqualify the NUA election and the entire market value of the company stock not rolled into an IRA will be taxed at ordinary income tax rates. A 10% early distribution penalty may apply to the Trustee's Cost if the participant is under 59 ½ and does not qualify for an exception. One such exception is available when an individual over age 55 separates from service and has been employed with Procter & Gamble for at least 5 years.

By taking advantage of the NUA strategy as part of your distribution from your P&G PST, you can benefit from the treatment of long-term capital gains taxes on your appreciated stock and it can be an excellent tax strategy as part of your overall financial plan. Due to the highly complex nature of retirement plan distributions, we recommend consulting your financial, legal, and tax advisors before making any final decisions.

At Wealth Dimensions Group, we successfully manage Trustee's Cost strategies for many P&G retirees. We hope to help you navigate your PST distribution to get the most out of your retirement savings. To find out more about Wealth Dimensions Group, visit us at www.wealthdimensions.com or contact Rob Lemmons at 513-554-6000. Also, please visit our website and follow the "Subscribe" link to receive our P&G publications.

Rob Lemmons CFP®, CPA, AIF® possesses expertise in working closely with Procter & Gamble retirees to guide them in all distribution options available in the P&G PST. In addition, he helps implement tax planning strategies that maximize tax savings by utilizing Trustee's Cost as an integral part of the client's overall retirement plan.

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