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Planning for IRD After Elimination of the State Death Tax Credit

Income in respect of a decedent may be the asset subject to the highest tax of all the assets in a decedent's estate. A key strategy is being aware of the right to IRD in the lifetime planning process and taking action to try to minimize the tax.

JONATHAN G. BLATTMACHR AND MITCHELL M. GANS, ATTORNEYS

Generally, the income tax basis, for federal income tax purposes, of an asset included in the gross estate of a decedent (or otherwise passing from the decedent at death) is equal, under Section 1014(a), to its estate tax value (normally equal to the asset's fair market value ("FMV") on the date of death or, if it applies, the FMV on the alternate valuation date determined under Section 2032). This change-of-basis rule is subject to an important exception for income in respect of a decedent ("IRD").¹

Virtually every estate will include the right to IRD. The primary section of the Tax Code that deals with IRD is Section 691. Although this section does not contain a definition or explanation of the term, guidance is provided in the Regulations. Reg. 1.691(a)-1(b) states, in effect, that IRD is gross income to which the decedent was entitled at the time of death but which was not includable in the

decedent's gross income for any period prior to death. Because virtually all individuals are cash method taxpayers and for other reasons, amounts received after the death of the decedent are often not reported on a pre-death return. Hence, almost all estates include the right to IRD.

The guidance provided in the Regulations is often insufficient to determine what is and what is not IRD. For example, inherent gain in most property (such as appreciation in publicly traded securities) is not IRD even though the decedent during lifetime could have cap-

tured the profit at any time just by placing an order to sell the stock. On the other hand, certain income that the decedent could never have collected (that is, he or she was never going to become entitled to it) no matter how long he or she lived is IRD.²

In fact, reference to case law and Revenue Rulings is frequently necessary to determine if an asset represents the right to IRD. Common examples of IRD are accrued interest,³ declared but unpaid dividends,⁴ inherent capital gain in assets sold the gain on which is being reported under the installment method under Section 453,⁵ and deferred compensation,⁶ including Section 401 (retirement) plans, individual retirement accounts ("IRAs"), and compensation stock options.⁷

IRD is taxed when collected after death or, in some cases, when disposed of after death, such as using the right to IRD to fund a pecuniary (fixed sum of money) bequest.

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EXHIBIT 1**Pre-2002: State Death Tax Equal to § 2011 Credit; No Extra State (or Local) Income Tax**

<i>Pre-Death Collection of Income That Would Be IRD</i>		\$1,000,000	
Taxable income collected before death	\$1,000,000		
Federal income tax rate	x .35		
Pre-death income tax ¹		\$350,000	
Increase in taxable estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$650,000		
State estate tax rate	x .16		
State estate tax		\$104,000	
Federal estate tax rate (net of § 2011 credit)	.39		
Federal estate tax (net of § 2011 credit)		\$253,500	
Total taxes		\$707,500	
Net to inheritor			\$292,500
<i>Post-Death Collection of IRD</i>		\$1,000,000	
Increase in taxable estate on acct. of right to IRD	\$1,000,000		
State estate tax rate	x .16		
State estate tax		\$160,000	
Federal estate tax rate (net of § 2011 credit)	.39		
Federal estate tax net (net of § 2011 credit)		\$390,000	
Amount of IRD included in gross income	\$1,000,000		
Deduction allowed under § 691(c) (net fed. est. tax)	\$390,000		
Net taxable IRD	\$610,000		
Federal income tax rate	x .35		
Federal income tax		\$213,500	
Total taxes		\$763,500	
Net to inheritor			\$236,500
Advantage (Disadvantage) to Pre-Death Collection of What Would Be IRD			\$56,000

A type of double taxation

The *right* to the IRD may be subject to federal (and, perhaps, state) estate tax. Furthermore, the IRD itself may be subject to federal (and, perhaps, state and/or local) income tax when collected or disposed of. In other words, it has to run the gauntlet of two tax regimes. It seems that the value of the right to IRD is not discounted for fed-

eral estate tax purposes for the inherent income tax liability

embedded in the assets.⁸ Nor is a deduction allowed under Section

¹ See Section 1014(c)

² See, e.g., Estate of O'Daniel, 173 F.2d 966, 37 AFTR 1249 (CA-2, 1949) (survivor benefits paid by the decedent's employer).

³ See, e.g., Rev. Rul. 76-153, 1976-1 CB 180.

⁴ Rev. Rul. 64-308, 1964-2 CB 176; see also Estate of Cartwright, TCM 1996-286.

⁵ Section 691(a)(4); cf. Sun First Nat'l Bank of Orlando, 607 F.2d 1347, 44 AFTR2d 79-5863 (Ct. Cl., 1979).

⁶ Hess, 271 F.2d 104, 4 AFTR2d 5638 (CA-3,

1959).

⁷ Ltr. Rul. 200012076. Neither a private letter ruling nor a technical advice memorandum may be cited or used as precedent. Section 6110(k)(3).

⁸ See, e.g., Estate of Smith, 300 F. Supp. 2d 474, 93 AFTR2d 2004-556 (DC Tex., 2004), *aff'd* 391 F.3d 621, 94 AFTR2d 2004-6891 (CA-5, 2004), Estate of Kahn, 125 TC No. 11 (2005). For a discussion of Estate of Kahn, see "Current Tax Developments," p. 35, this issue.

EXHIBIT 2**After 2004 and Before 2010: No Extra State (or Local) Income or Estate Tax**

<i>Pre-Death Collection of Income That Would Be IRD</i>		\$1,000,000	
Taxable income collected before death	\$1,000,000		
Federal income tax rate	<u>X.35</u>		
Pre-death income tax		\$350,000	
Increase in taxable estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$650,000		
Federal estate tax rate	<u>X.45</u>		
Federal estate tax on this net income		\$292,500	
Total federal income and estate taxes		\$642,500	
Net to inheritor			\$357,500
<i>Post-Death Collection of IRD</i>		\$1,000,000	
Increase in taxable estate on acct. of right to IRD	\$1,000,000		
Federal estate tax rate	<u>X.45</u>		
Federal estate tax on the right to IRD		\$450,000	
Am't. of gross IRD included in gross income	\$1,000,000		
Deduction allowed under § 691(c) (net fed. est. tax)	<u>\$450,000</u>		
Net taxable IRD	\$550,000		
Federal income tax rate	<u>X.35</u>		
Federal income tax		\$192,500	
Total federal estate and income taxes		\$642,500	
Net to inheritor			\$357,500
Advantage (Disadvantage) to Pre-Death Collection of What Would Be IRD			None

2053 for federal estate tax purposes for the income tax paid on the IRD.⁹

However, an income tax deduction is permitted under Section 691(c) for the net federal estate tax paid on the right to the IRD. As indicated, no deduction is permitted for any state (or foreign) estate tax paid on the right. The effect of the Section 691(c) deduction is to reduce the impact or cost of the federal estate tax. In effect, the deduction compensates for the Tax

Code's failure to permit an estate tax deduction for the income tax liability that the IRD will generate.

The impact of state death tax on the income taxation of IRD

Prior to 2002, all states imposed a state death tax at least equal to the state death tax credit permitted, dollar for dollar, against the federal estate tax under Section 2011. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), the state death tax credit was eliminated and replaced with a deduction.

Prior to EGTRRA, that portion of the federal estate tax that was reduced by the state death tax credit (and paid to one or more states and not to the federal government) was not allowed as part of the deduction under Section 691(c). That is, the deduction was computed with reference to the net federal estate tax (i.e., net of the credit permitted for the state death tax). Consequently, there was "over-taxation" with respect to IRD: full state death taxation and full federal (and, perhaps, state and local) income taxation was imposed on

⁹ *Id.*

EXHIBIT 3 Impact of § 68: No Extra State (or Local) Income or Estate Tax

<i>Pre-Death Collection of Income That Would Be IRD</i>		\$1,000,000
Taxable income collected before death	\$1,000,000	
Federal income tax rate	<u>x .35</u>	
Pre-death income tax		\$350,000
Increase in taxable estate after pre-death income tax paid for § 2053 deduction taken if not paid by death	\$650,000	
Federal estate tax rate	<u>x .45</u>	
Federal estate tax on this net income		\$292,500
Total federal income and estate taxes		\$642,500
Net to inheritor		\$357,500
<i>Post-Death Collection of IRD</i>		\$1,000,000
Increase in taxable estate on acct. of right to IRD	\$1,000,000	
Federal estate tax rate	<u>x .45</u>	
Federal estate tax on the right to IRD		\$450,000
Amt. of gross IRD included in gross income	\$1,000,000	
§ 691(c) (net fed. est. tax) before § 68	\$450,000	
Amount disallowed as deduction under § 68	<u>\$20,000</u>	
Net amount deductible under § 691(c)	\$430,000	
Net taxable IRD	\$570,000	
Federal income tax rate	<u>x .35</u>	
Federal income tax		\$199,500
Total federal estate and income taxes		\$649,500
Net to inheritor		\$350,500
Advantage (Disadvantage) to Pre-Death Collection of What Would Be IRD		\$7,000

the IRD. In other words, the Section 691(c) deduction did not take into account the impact of the state death tax.

Nevertheless, if the income that would represent IRD were collected prior to death and, as a result, taxed to the decedent, then over-taxation would be avoided, as illustrated by Exhibit 1. The reason is that all income tax (federal, state, and local) paid before, or payable at the time of, the decedent's death would have the effect of reducing the decedent's taxable estate for state (as well as federal) estate tax purposes.

Thus, it was often preferable for the income to be collected prior to death. But now, and under current law until at least 2011, the state death tax credit has been totally eliminated and replaced with an unlimited estate tax deduction under Section 2058 for state death tax paid. (The federal estate tax, under current law, will be repealed for estates of persons dying in 2010; the full complement of federal estate tax provisions as they existed prior to EGTRRA, including restoration of the state death tax credit and the elimination of the deduction for state death tax paid,

will be restored with respect to estates of persons dying after 2010.) That raises the question of whether the elimination of the state death tax credit or the allowance of the estate tax deduction for state death tax paid changes planning with respect to an asset that would represent the right to IRD.

Impact of elimination of state death tax credit

If there is no state death tax, this kind of over-taxation cannot occur and, therefore, there will not be any advantage in collecting IRD income prior to death if all other factors

are equal, as is illustrated by Exhibit 2. Prior to EGTRRA, over-taxation did not always occur. Even though all states prior to 2002 imposed a state death tax at least equal to the state death tax credit, no state death tax could be imposed if the decedent was not domiciled in any state at the time of death.

For example, the decedent at death might have been a U.S. citizen but domiciled outside the U.S. or in one of its territories, and might have owned no real or tangible personal property in one or more of the states. (A state may impose its death tax on real and tangible personal property actually situated there even if the owner at death is domiciled elsewhere.) In such a case, there would have been no state death tax imposed, and, therefore, no need to collect the IRD before death in order to avoid over-taxation, provided all other factors (such as the rate of income taxation on the income whether collected before or after death) were the same.

In other words, if no state death tax is imposed, which is the case

now for a majority of states, the advantage illustrated by Exhibit 1 inherent in the pre-death collection of IRD disappears, although as indicated and as is discussed below other factors may suggest pre-death collection nevertheless may be advantageous in some cases. Again, the lack of that advantage is illustrated by Exhibit 2. Hence, if all other things are equal (and they certainly may not be), there is no advantage in pre-death collection of IRD. In fact, pre-death collection may have the effect of accelerating income and, as a consequence, tax liability—resulting in a potential “time use of money” disadvantage.

Independent state death tax

Several states (such as New York) impose a state death tax even though no portion of that tax is creditable against the federal estate tax. Under Section 691(c), no portion of the state death tax is deductible for federal income tax purposes. Accordingly, the full cost of state death taxation on the right

to IRD (i.e., the over-taxation discussed above) continues in effect. And that is the case even though the state death tax is deductible for federal estate tax purposes without limit under Section 2058. (See Exhibit 3.) As Exhibit 3 illustrates, the person who succeeds to the right to the IRD suffers two detriments: higher overall death taxation (because no portion of the state death tax is creditable) and no income tax deduction for the state death tax paid. Therefore, overall taxes on the right to IRD often will increase during the time that the state death tax is not creditable (but only deductible for federal estate tax purposes).

As illustrated by Exhibit 3, a person succeeding to what would be the right to IRD nets less than what he or she would succeed to if there were no state death tax, as illustrated in Exhibit 2, because of the extra state death tax. That, of course, is true even with respect to assets whose bases are equal to their estate tax values under Section 1014(a). And, in the case of IRD, while a shift to a deduction



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EXHIBIT 4 Impact of State Estate Tax (and § 2058 Deduction Federal Only) but No Extra State (or Local) Income Tax

<i>Pre-Death Collection of Income That Would Be IRD</i>		\$1,000,000	
Taxable income collected before death	\$1,000,000		
Federal income tax rate	<u>x.35</u>		
Pre-death income tax		\$350,000	
Increase in state taxable estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$650,000		
State estate tax rate	<u>x.16</u>		
State estate tax on this net income		\$104,000	
Increase in taxable estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$650,000		
Increase in federal gross estate after pre-death income tax § 2058 deduction for state estate tax	<u>-\$104,000</u>		
Increase in federal taxable estate on pre-death income	\$546,000		
Federal estate tax rate	<u>x.45</u>		
Federal estate tax on this pre-death income		\$245,700	
Total federal income and estate taxes		<u>\$699,700</u>	
Net to inheritor			\$300,300
<i>Post-Death Collection of IRD</i>			\$1,000,000
Increase in state taxable estate on acct. of right to IRD	\$1,000,000		
State estate tax rate	<u>x.16</u>		
State estate tax on right to IRD		\$160,000	
Increase in federal gross estate on acct. of right to IRD	\$1,000,000		
§ 2058 deduction for state estate tax	<u>-\$160,000</u>		
Increase in federal taxable estate on acct. of right to IRD	\$840,000		
Federal estate tax rate	<u>x.45</u>		
Federal estate tax on the right to IRD		\$378,000	
Amount of IRD included in gross income	\$1,000,000		
Deduction allowed under § 691(c) (net fed. est. tax)	<u>-\$378,000</u>		
Net taxable IRD	\$622,000		
Federal income tax rate	<u>x.35</u>		
Federal income tax		\$217,700	
Total federal estate and income taxes		<u>\$755,700</u>	
Net to inheritor			<u>\$244,300</u>
Advantage (Disadvantage) to Pre-Death Collection of What Would Be IRD			<u>\$56,000</u>

EXHIBIT 5
Impact of State Estate Tax (and § 2058 Deduction Federal and State) but No Extra State (or Local) Income Tax

<i>Pre-Death Collection of Income That Would Be IRD</i>		\$1,000,000
Taxable income collected before death	\$1,000,000	
Federal income tax rate	<u>x.35</u>	
Pre-death income tax		\$350,000
Increase in state gross estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$650,000	
§ 2058 deduction for state estate tax	<u>- \$89,655</u>	
State taxable estate	\$560,345	
State estate tax rate	<u>x.16</u>	
State estate tax on this net income		\$89,655
Increase in taxable estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$650,000	
§ 2058 deduction for state estate tax	<u>- \$89,655</u>	
Increase in federal taxable estate on pre-death income	\$560,345	
Federal estate tax rate	<u>x.45</u>	
Federal estate tax on this pre-death income		\$252,155
Total federal income and estate taxes		<u>\$691,810</u>
Net to inheritor		\$308,190
<i>Post-Death Collection of IRD</i>		\$1,000,000
Increase in state gross estate on acct. of right to IRD	\$1,000,000	
§ 2058 deduction for state estate tax	<u>- \$137,931</u>	
State taxable estate	\$862,069	
State estate tax rate	<u>x.16</u>	
State estate tax on this net income		\$137,931
Increase in federal gross estate on acct. of right to IRD	\$1,000,000	
§ 2058 deduction for state estate tax	<u>- \$137,931</u>	
Increase in federal taxable estate on acct. of right to IRD	\$862,069	
Federal estate tax rate	<u>x.45</u>	
Federal estate tax on the right to IRD		\$387,931
Amount of gross IRD included in gross income	\$1,000,000	
Deduction allowed under § 691(c) (net fed. est. tax)	<u>- \$387,931</u>	
Net taxable IRD	\$612,069	
Federal income tax rate	<u>x.35</u>	
Federal income tax		\$214,224
Total federal estate and income taxes		<u>\$740,086</u>
Net to inheritor		<u>\$259,914</u>
Advantage (Disadvantage) to Pre-Death Collection of What Would Be IRD		<u>\$48,276</u>

EXHIBIT 6**Impact of State Estate Tax (and § 2058 Deduction Federal Only) and Extra State (or Local) Income Tax**

<i>Pre-Death Collection of Income That Would Be IRD</i>			\$1,000,000
Taxable income collected before death	\$1,000,000		
Combined federal and state income tax rate	<u>x.45</u>		
Pre-death income tax		\$450,000	
Increase in state taxable estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$550,000		
State estate tax rate	<u>x.16</u>		
State estate tax on this net income		\$88,000	
Increase in federal gross estate after pre-death income tax paid (or § 2053 deduction taken if not paid by death)	\$550,000		
§ 2058 deduction for state estate tax	<u>- \$88,000</u>		
Increase in federal taxable estate on pre-death income	\$462,000		
Federal estate tax rate	<u>x.45</u>		
Federal estate tax on this pre-death income		\$207,900	
Total federal income and estate taxes			\$745,900
Net to inheritor			\$254,100
<i>Post-Death Collection of IRD</i>			1,000,000
Increase in state taxable estate on acct. of right to IRD	\$1,000,000		
State estate tax rate	<u>x.16</u>		
State estate tax on this net income		\$160,000	
Increase in federal gross estate on acct. of right to IRD	\$1,000,000		
§ 2058 deduction for state estate tax	<u>- \$160,000</u>		
Increase in federal taxable estate on acct. of right to IRD	\$840,000		
Federal-estate tax rate	<u>x.45</u>		
Federal estate tax on the right to IRD		\$378,000	
Amount of gross IRD included in gross income	\$1,000,000		
Deduction allowed under § 691(c) (net fed. est. tax)	<u>- \$378,000</u>		
Net taxable IRD	\$622,000		
Combined federal and state income tax rate	<u>x.45</u>		
Federal and state income tax		\$279,900	
Total federal estate and income taxes			\$817,900
Net to inheritor			\$182,100
Advantage (Disadvantage) to Pre-Death Collection of What Would Be IRD			\$72,000

under Section 2058 away from the Section 2011 credit may ameliorate over-taxation somewhat (in that it converts state estate tax liability into federal estate tax liability), the advantage of pre-death collection may continue. For example, in the illustration in Exhibit 4, there is a \$56,000 advantage to pre-death collection of the income. That advantage is attributable to the denial of the state death tax as a Section 691(c) deduction [$\$160,000$ (state estate tax) \times .35 (federal income tax rate) = \$56,000].

In other words, Exhibit 4 illustrates that there may continue to be an advantage to pre-death collection of the income that would be IRD when the state imposes a death tax, all other factors being equal. Exhibit 5 demonstrates the same advantage even if the state death tax is deductible not only for federal but for state death tax purposes as well.

No change in advantage where state income tax is imposed

The potential advantage of pre-death collection while the state

death tax is deductible applies also, all other factors being equal, where a state (or local) income tax is paid. (See Exhibit 6.) Nevertheless, as discussed below, pre-death and post-death income taxation factors may suggest post-death collection may be preferable in some cases.

Other factors may re-enforce or change the advantage of pre-death collection of the income

Despite the fact that there may be an advantage to the pre-death collection of income that would be IRD, other factors need to be considered. Some of these may re-enforce that pre-death collection is preferable. Other factors may suggest the collection after death is better.

As mentioned above, pre-death collection of income that would be IRD likely means earlier payment of tax, meaning that (if all other things are equal) waiting until after death to collect the income (as IRD) may provide a "time use of money" advantage. That could be the result in Exhibit 2, but that is not neces-

sarily the case. For example, suppose that a person collects the income during lifetime in January 2006 and dies later that month. The income tax on that income might not be payable until 4/15/07. If the taxpayer did not collect the income before death and the estate collected it in February 2006 and chose a February tax year, the income tax on the income would be due on 6/15/06.

Pre-death collection of income forecloses postponing the collection of what would be IRD, such as with an IRA where the inheritor (that is, the successor beneficiary) may "spread" payments over lifetime. Accordingly, waiting until after death to collect the income (as IRD) may provide a very significant "time use of money" advantage.

Post-death collection of income may avoid state and/or local income tax because the income is collected by (or deemed distributed as distributable net income ("DNI") to) a taxpayer who is in a lower income tax bracket than the decedent would have been in if the income

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had been collected before death. For example, a New Yorker may structure his or her estate plan so that income collected after death (unless it represents New York-source income) is not subject to New York income tax. Under New York Tax Law section 605, a trust created by a New Yorker is not subject to New York State or City income tax if, among other conditions, no New Yorker is a trustee. The New Yorker may arrange for post-death income collections of IRD to be reportable by such a trust either by assigning the right to the IRD to a revocable trust prior to death or by having the executor of the New Yorker's will distribute the IRD, if it constitutes DNI within the meaning of IRC Section 643(a), to such a trust.

Alternatively, the IRD (if it constitutes DNI) could be distributed to a beneficiary who is not a New Yorker, resulting in the avoidance of New York income tax as long as the IRD does not represent New York-source income (which is taxable by New York even to a non-New Yorker). Not collecting the income prior to death may provide an opportunity—if the IRD is payable to a trust—to convert what would be “ordinary” income IRD into long-term capital gain income.¹⁰

Pre-death collection may result in higher adjusted gross income (“AGI”), which may affect the decedent's deductions (such as for charitable contributions under IRC Section 170(c) and medical expenses under Section 213), and may affect whether the decedent is subject to the alternative minimum tax under Section 55.

The reduction in the Section 691(c) deduction by reason of IRC Section 68 needs to be carefully considered in planning. Section 68 disallows certain itemized deductions (but never more than 80% of such deductions), including the Section

691(c) deduction, equal to 3% of the amount by which the taxpayer's AGI for the year exceeds \$100,000 (this amount has been and will continue to be adjusted for cost of living).¹¹ If the income is collected prior to death, more of the taxpayer's itemized deductions may be disallowed under Section 68 by reason of the increased income. The same may happen with respect to post-death collection of the IRD: the AGI of the person required to include the IRD in gross income is increased, resulting in a similar disallowance of itemized deductions. It should be emphasized that the Section 691(c) deduction is an itemized deduction for this purpose. (See Exhibit 3 for an illustration of the potential impact of Section 68 with respect to post-death collection of the IRD.)

Nevertheless, post-death collection does offer a potential advantage with respect to Section 68: under Section 68(e), Section 68 does not apply to a decedent's estate or to a trust. Hence, by arranging for the IRD to be collected by the estate or a trust, the loss of the allowance of the Section 691(c) deduction by reason of Section 68 may be avoided, unless the IRD constitutes DNI and is distributed out to a beneficiary who is an individual. This latter point is important to consider with respect to retirement plan (including IRA) distributions. Although a trust may be a recipient of such distributions, and in some cases with the same long-term payout options available to distributions to individuals, the amount collected (which may represent IRD) may be distributed currently to an individual beneficiary of the trust.¹²

Income tax on pre-death collection of income may result in a reduced marginal estate tax bracket. This may provide an advantage to pre-death collection of the

income. For example, assume a decedent's estate includes the right to IRD in the amount of \$1 million. Based on the decedent's adjusted taxable gifts and other assets that will comprise his or her taxable estate, the first \$650,000 of the right to IRD will be subject to an estate tax rate of 43% and the last \$350,000 of the right to IRD will be subject to an estate tax rate of 45%. By collecting the income prior to death, and assuming it will be subject to income tax of 35%, only \$650,000 of the \$1 million that would have represented the right to IRD will be subjected to estate tax and at a rate of 43% only.

The bottom line

Planning for IRD may be complicated. IRD may be the asset subject to the highest tax of all assets included in the decedent's estate. A key is being aware of the right to IRD in the lifetime planning process and taking action to try to minimize the tax. Often, but not always, pre-death collection of the income will accomplish that. Running the numbers usually will be critically important. Whether state death tax will be creditable against the estate's federal estate tax or only deductible for federal estate tax purposes, no part of the state death tax may be taken into account for purposes of computing the Section 691(c) deduction, which means there is no offset or reduction in the cost of state death tax as there is for the federal estate tax on the right to IRD. ■

¹⁰ Not collecting the income prior to death may provide an opportunity—if the IRD is payable to a trust—to convert what would be “ordinary” income IRD into long-term capital gain income. See Jones, “Trading on Interests in Trusts Holding Unrealized IRD,” Tax Notes 211 (4/11/05).

¹¹ In 2006, the amount of the disallowance is equal to 2% of the excess (in other words, the amount disallowed is equal to two-thirds of the amount disallowed in prior years). See Section 68(f).

¹² See, generally, Choate, *Life and Death Planning for Retirement Benefits* (5th ed. 2003), chapter 6 2