

# Many heirs miss out on a valuable tax deduction

Settling an estate can be complicated. Ask your tax or financial advisor to make sure the IRD deduction does not get lost in the process.

## What is the IRD tax deduction?

Income in respect of a decedent (IRD) is income that was owed to a decedent at the time he or she died. Examples of IRD include retirement plan assets, IRA distributions, unpaid interest and dividends, salary, wages, and sales commissions, to name only a few. Items of IRD, along with other estate assets, are eventually distributed to the beneficiaries of an estate. While the beneficiaries receive most assets of the estate income-tax free, IRD assets are generally taxed at beneficiaries' ordinary income tax rates. However, if a decedent's estate has paid federal estate taxes on the IRD assets, a beneficiary may be eligible for an IRD tax deduction based on the amount of estate tax paid. Best of all, the IRD deduction is not subject to the 2% floor, as are other miscellaneous itemized deductions.

With tax advisors and attorneys focused on the estate-tax return and the transfer of assets, it is easy to overlook the potential for heirs to benefit from IRD deductions. Here's how to make sure you get the tax benefits you deserve.

## Examine the decedent's estate-tax return

To determine if you can benefit from the IRD tax deduction, obtain a copy of the decedent's estate-tax return (IRS Form 706) from the executor or administrator of the estate. Look to see if the estate paid an estate tax (for 2017, estates valued at less than \$5.49 million will not owe estate tax). Then, take note of the value of any items of IRD you inherited. **If estate tax was paid on those items, it is likely that you can claim the IRD deduction. If the decedent's estate did not pay estate tax on the IRD assets, then the beneficiaries can claim no IRD deduction.**

## Claim the IRD deduction

Working with your tax advisor, calculate how much of the decedent's estate tax was attributable to the items of IRD that you inherited. This amount can be claimed on your tax return. **You must itemize deductions by filling out Schedule A, Miscellaneous Itemized Deductions, on IRS Form 1040. You must claim the IRD deduction in the same tax year in which you actually received the income.**

**The IRD deduction can reduce the income tax that beneficiaries may owe on certain inherited assets.**

## Calculate the IRD deduction

This example assumes a person dies in 2016 with a gross estate of \$8.49 million, of which \$1 million is IRD assets.

### STEP 1

#### Calculate estate tax

Examine the decedent's estate-tax return calculation

Gross estate	\$8,490,000
Less deductions	-1,000,000
Adjusted taxable estate	\$7,490,000

Tentative estate tax*	\$2,941,800
Less unified credit	-2,141,800
<b>Total federal estate tax</b>	<b>\$800,000</b>

### STEP 2

#### Recalculate estate tax, exclude IRD

Figure the estate tax again. This time, exclude the IRD assets from the calculation. Next, compare the difference in federal estate-tax liability from Steps 1 and 2. The difference represents the estate tax that was levied on the decedent's IRD assets.

Gross estate	\$8,490,000
Less deductions	-1,000,000
Adjusted taxable estate	\$7,490,000

<b>Less IRD assets</b>	<b>-1,000,000</b>
<b>Adjusted taxable estate without IRD</b>	<b>\$6,490,000</b>

Tentative estate tax*	\$2,541,800
Less unified credit	-2,141,800
<b>Total federal estate tax</b>	<b>\$400,000</b>

### STEP 3

#### Calculate IRD tax deduction

This is the amount that can be claimed by beneficiaries as an IRD deduction.

Federal estate tax	\$800,000
Federal estate tax without IRD	-400,000
<b>Tax attributable to IRD</b>	<b>\$400,000</b>

IRD DEDUCTION

**Work with your tax advisor to calculate your IRD deduction.**

\* From IRS tax table.

## Claim only the amount you are entitled to

Using this example, if the beneficiary received the entire \$1 million in IRD assets, he or she could claim the entire \$400,000 IRD tax deduction.

**Note:** If there were multiple beneficiaries and each beneficiary received only a portion of the decedent's IRD assets, the beneficiaries could claim only their proportionate share of the IRD deduction amount. Returning to this example, if the beneficiary received \$200,000 of the decedent's \$1 million IRD assets (20%), he or she could claim 20% of the \$400,000 IRD deduction amount (\$80,000). Other beneficiaries could claim their pro rata share of the IRD deduction on their tax returns.

## Additional resources

- IRS Publication 559, *Survivors, Executors, and Administrators*
- Putnam 2017 tax rates, schedules, and contribution limits chart (II952)
- Professional tax advisor

This information is not meant as tax or legal advice. You should consult with the appropriate tax or legal professional before making any tax or investment decisions.