TENTH OF AN HOUR

Episode 44: The Income Tax Deduction for Estate Tax on IRD: Code Section 691(c)

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This presentation is not legal or tax advice

What is the Section 691(c) deduction?

- It reduces income tax liability on income in respect of a decedent (IRD), by granting a deduction for any estate tax liability generated by that IRD
- Classified as miscellaneous deduction, not subject to 2% of AGI floor or AMT preference
- What is IRD?
  - Income earned before death but received after death
- Why do we care?
  - IRD is included in the gross estate and is subject to both estate tax and income tax
  - IRD gets no step-up in income tax basis
  - IRD can be significant, especially in the case of IRAs or tax-deferred assets

How do we compute the deduction?

- First, must have estate tax liability generated by IRD
  - Preparer of individual tax return must have copy of estate’s 706
  - For zero tax estate, no deduction available
  - If IRD qualifies for estate tax marital deduction, no deduction available
- Second, determine amount of estate tax generated by IRD that will go to taxpayer
  - For installments to be received over time, such as from an IRA, it helps to just determine the entire deduction up front
  - Importantly, this treats IRD in the taxable estate as last-dollar when computing deduction

Example

- Assume taxable estate of $15,200,000, which after the applicable credit in 2020 ($4,577,800 credit on $11,580,000 exclusion) generates estate tax liability of $1,448,000.
- Assume that estate includes an IRA in the amount of $1,200,000, for which the sole beneficiary is a non-married partner (so no marital deduction).
- Estate tax without the IRA would be $968,000
- Difference is $480,000 (40% of value of IRA)
- This represents lifetime deduction for partner against IRA distributions, but little to no guidance exists on how to apply deduction

One deduction approach - FIFO

- Assume that beneficiary partner of IRA has to take an RMD of $100,000 for the calendar year of the year following IRA owner's death
- FIFO approach would apply $480,000 of the deduction dollar-for-dollar against the $100,000 deduction
- Partner has $380,000 of deduction to use in later years
- Easiest approach but exhausts deduction early

Another deduction approach - lifetime

- IRD deduction tracks lifetime distributions from IRA
- Problem is that if partner does not outlive actuarial life expectancy, some deduction is lost
- Approach would match RMD factor to deduction available
- Example: Partner must take 1/20th of IRA as RMD for year one, which is $60,000 (assuming no IRA growth)
  - In this case, deduction would be 1/20th of $480,000, or $24,000
  - This leaves $36,000 of deduction taxable
  - Next year, 1/19th of IRA is distributed, and 1/19th of remaining deduction ($24,000 of $456,000) taken as well

Where to report:

- Line 16 of Schedule A of 1040 (must itemize to get deduction) for individuals

Other Itemized Deductions	**16**	Other—from list in instructions. List type and amount ▶	**16**	
Total	**17**	Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on		

- Line 15a of Form 1041 for estates and trusts (include statement listing deductions); doesn't offset IRD distributed to beneficiaries

15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e)	**15a**

QUESTIONS?

- Send questions and topic suggestions to griffin.bridgers@gmail.com