



CHECKLIST

The Word on IRD

Probably for the same reason people tend to put off making their wills, taxpayers often neglect to plan for the effects on their heirs of income they were entitled to receive but didn't live long enough to see.

So-called "income in respect to a decedent" (IRD) includes, for example, a final paycheck or other income distributed after an employee's death. Failure to plan for this income can cost an estate and its beneficiaries a lot of money. Reduce IRD's impact with these six tips:

- ✓ **Name the spouse as beneficiary of retirement accounts.** For married taxpayers, perhaps the easiest way to delay the bite of much of the IRD from IRAs and other retirement accounts is through a spousal rollover. This strategy generally postpones any estate tax on the accounts and slows the imposition of income taxes on the payouts. A surviving spouse receiving an IRA rollover can generally delay required minimum distributions from the IRA until he or she reaches the age of 70½, and then payments can be stretched out over his or her remaining lifetime. In addition, under the Pension Protection Act of 2006, a decedent's IRA may be rolled over into one established for the benefit of a non-spouse beneficiary, who is then subject only to minimum distribution requirements of inherited IRAs.
- ✓ **Name a younger beneficiary to the survivor's IRA.** Doing so may further stretch out payments. If the survivor

dies before the required beginning date for taking minimum distributions, the amount to be distributed is determined by dividing the account balance at the beginning of the year following the death by the beneficiary's remaining life expectancy. If the survivor was already taking minimum distributions when he or she died, then the account balance is divided by the larger of the owner's or beneficiary's remaining life expectancy.

- ✓ **Funnel IRD assets into a credit shelter trust.** Where preserving assets for children by fully using the estate tax exemption for both spouses is paramount, a credit shelter trust may be the right choice. When the first spouse dies, an amount equal to his or her exemption—currently \$2 million—passes to a trust from which the surviving spouse can benefit during his or her lifetime but which will not be included in his or her estate at death.
- ✓ **Donate IRD assets to charity.** Specific pre-residuary bequests fulfilled with IRD assets will save the estate taxes on the value of the IRD assets used [because of the unlimited charitable deduction of IRC section 642(c)], as well as the taxes that the non-charitable residual beneficiaries would have otherwise had to pay on the IRD asset as they received the income.
- ✓ **Don't overlook the IRD income tax deduction.** An amount equal to the

portion of estate tax attributable to net IRD items after deductions the decedent would have taken is treated as a miscellaneous itemized deduction not subject to the 2% of adjusted gross income floor or the alternative minimum tax. However, because IRA payments typically are spread out over a period, such as the taxpayer's life expectancy, the maximum deduction is also spread out over that period. If the taxpayer doesn't use up the deduction before his or her death, it can be carried over to his or her heirs. Doing so requires careful recordkeeping.

- ✓ **Favor the Roth IRA.** Since Roth IRAs are not considered IRD assets and qualified distributions from them are not subject to income tax, your clients can consider making contributions to a Roth versus a traditional IRA. The trade-off is that they miss out on the current-year tax deduction they would receive for contributions to a traditional IRA. Clients who have already set up a traditional IRA can consider the tax implications of rolling it over into a Roth IRA. A distribution to a beneficiary or to the Roth IRA owner's estate on or after the date of death is a qualified distribution if it is made after the five-taxable-year period beginning with the first tax year in which a contribution was made to any Roth IRA of the owner.

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