Income in Respect of a Decedent (IRD)

Description and Operation

Income in Respect of a Decedent (IRD) is all the income a decedent would have received had death not occurred, but was not properly includible in his/her final income tax return. IRD must be included in the income of the decedent's estate, if the estate receives it. Or if the beneficiary receives the income, it is income on the beneficiary's income tax return. IRD retains the same tax nature after death as it would have had if the decedent had received the item of income while alive. There is no step-up in basis for IRD items.

Common types of IRD include the taxable portions of Series EE US Savings Bonds, IRAs and retirement plans, annuities, deferred compensation, wages and vacation time paid after death, installment payments, farm rent earned from crops or livestock of a cash taxpayer, interest and dividends earned but not received before death, unpaid partnership liquidation distributions, and renewal commissions. Wages paid as income in respect of a decedent after the year of death generally are not subject to withholding for any federal taxes.

Claiming the IRD Deduction

One of the most frequently missed deductions available to recipients of IRD is the estate tax deduction attributable to those IRD items. If the estate owes estate transfer tax on Form 706, some of the tax is attributable to the IRD items. When the ultimate recipient receives the items of IRD, the recipient must include the IRD in income and pay income tax. Thus, items of IRD are potentially taxed twice.

The IRD estate tax deduction is calculated by re-computing the Form 706 without any IRD items, then subtracting this number from the true federal estate transfer tax bill. This difference is the estate tax due to the IRD items. A proportionate amount of the estate tax attributable to IRD items may be deducted, not subject to the 2% of AGI limit, by the recipient when reporting the income from the IRD item.

For example, assume the estate and then a beneficiary is receiving a decedent's 401(k), IRA, or the principal and interest on an installment note over a period of time. The estate can claim an IRD deduction for the years the estate receives the income. After the estate distributes the asset to the beneficiary, the beneficiary can deduct the IRD estate tax paid on Form 1040, recovered over time as the income is received.

Example

Jack used the cash method of accounting. At the time of his death, he was entitled to receive $12,000 from clients for his services and he had accrued bond interest of $8,000, for a total income in respect of a decedent of $20,000. He also owed business expenses of $5,000 for which his estate is liable. The income and expenses are reported on Jack's estate tax return.

The tax on Jack's estate is $9,460 after credits. The net value of the items included as income in respect of a decedent is $15,000 ($20,000 – $5,000). The estate tax determined without including the $15,000 in the taxable estate is $4,840 after credits. The estate tax that qualifies for the deduction is $4,620 ($9,460 – $4,840).

Figure the recipient's part of the deductible estate tax by dividing the estate tax value of the items of income in respect of a decedent included in the recipient's income (the numerator) by the total value of all items included in the estate that represents income in respect of a decedent (the denominator). If the amount included in the recipient's income is less than the estate tax value of the item, use the lesser amount in the numerator.

As the beneficiary of Jack's estate, you collect the $12,000 accounts receivable from his clients. You will include the $12,000 in your income in the tax year you receive it. If you itemize your deductions in that tax year, you can claim an estate tax deduction of $2,772, figured as follows:

$$\frac{\text{IRD included in your income}}{\text{Total IRD}} \times \text{Estate tax attributable to IRD} = \frac{\$12{,}000}{\$20{,}000} \times \$4{,}620 = \$2{,}772$$

Other Deductions

Items such as business expenses, income-producing expenses, interest, and taxes for which the decedent was liable but that are not properly allowable as deductions on the decedent's final income tax return will be allowed as a deduction to the estate or, if the estate was not liable for the decedent’s obligations, the person who acquired an interest in the decedent's property (subject to such obligations).

Similar treatment is given to the foreign tax credit. A beneficiary who must pay a foreign tax on income in respect of a decedent will be entitled to claim the foreign tax credit.

An heir who (because of the decedent's death) receives income as a result of the sale of units of mineral by the decedent (who used the cash method) will be entitled to the depletion allowance for that income.

An annuity received by a surviving annuitant under a joint and survivor annuity contract is considered income in respect of a decedent. The deceased annuitant must have died after the annuity starting date. You must make a special computation to figure the estate tax deduction for the surviving annuitant. See IRS regulations section 1.691(d)-1.

Practical Tax Reporting

Because the Social Security number on the tax reporting document will be the decedent’s, the income is commonly added to the final Form 1040 of the decedent, and then removed by referencing a nominee (the recipient of the item).

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