

Price & Farrington's Estate Planning

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Estate, Tax and Family Wealth Preservation Planning For Advisors

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Surprise! Use the Code to Offset Taxes on Income Paid After a Person's Death.

A growing number of taxpayers who qualify for tax breaks worth \$10,000, \$50,000 and more are throwing away this deduction every year because they have no idea it even exists. Billions of dollars are being lost. It is probably the most prevalent error today in respect to estate taxes. What are we talking about?...

Income of a decedent that was not paid prior to the decedent's death must be accounted for by the estate or by the beneficiary to whom it is paid.

This is known as income in respect of a decedent or IRD. A number of things, including accrued salary and installment payments, may constitute IRD. But probably the most common IRD items are distributions that come from pension, profit-sharing, 401K plans and individual retirement accounts.

IRD items are subject to estate taxes without reductions for the income taxes that the beneficiaries will ultimately pay.

To make up for this estate tax on assets that will ultimately be used to pay income tax, an income tax deduction is available

in the year the IRD is included in income—in an amount equal to the portion of the estate tax that was attributable to the IRD item. This is the little known, powerful 691(c) deduction.

The deduction generally results in a total tax liability equal to the liability that would have arisen had the decedent paid the income taxes on the IRD item before death.

Assume, for example, that an estate consists of an IRA of \$1 million payable to the decedent's daughter, that the estate is in a 50 percent estate tax bracket, and that the beneficiary is in a 40 percent income tax bracket. The estate would pay \$500,000 of estate taxes attributable to the individual retirement account. When the decedent's daughter withdraws the IRA funds she will claim \$1 million in income and deduct \$500,000 as a section 691(c) deduction.

The net amount of \$500,000 will be subject to income tax at 40 percent, resulting in a tax of \$200,000. After paying \$500,000 of estate tax and \$200,000 of income tax, she will be left with \$300,000.

If the decedent had withdrawn the IRA funds prior to his death, he would have paid income tax of \$400,000 (assuming that he was in the same 40 percent income tax bracket as his daughter).

The net amount of \$600,000 would have been includable in his estate for estate tax purposes, and it would be subject to an estate tax of \$300,000. His daughter would have been left with the same \$300,000.

Amazingly, the section 691(c) deduction is often overlooked. Pension and individual retirement accounts generally have designated beneficiaries, so the assets never pass through the probate estate into the hands of the personal representative.

Unless the personal representative contacts the beneficiary, the beneficiary



may very likely have no idea that a deduction is available, and certainly would have no way of calculating the amount of the deduction.

The section 691(c) deduction is based on the estate tax as finally determined. But, if the Internal Revenue Service audits the estate, the estate tax may not be finally determined for a number of years. Beneficiaries who take distributions during the interim may be forced to file amended income tax returns to claim the deduction after the estate tax is finally determined.

If an estate tax dispute is not settled at the audit level, it may even be necessary for the beneficiaries to file protective refund claims to make certain that any income tax deduction resulting from an increase in the estate tax payable will not be barred by the statute of limitations.

Remember to take advantage of the powerful Section 691(c)! ■



From all of us at:

Price & Farrington

Attorneys and Counselors at Law

You Are Invited To 3 Seminars!!

**"THE NUTS & BOLTS of
ESTATE PLANNING"**

Wed., Dec. 6, 1:00 p.m.- 3:15 p.m.

**"IRA PLANNING:
TOOLS, TIPS and TRAPS"**

Wed., Dec. 6, 7:00 p.m. - 9:15 p.m.

**"ADVANCED ESTATE PLANNING
FOR ESTATES OF \$2M and UP"**

Thurs., Dec. 7, 10:00 a.m.-12:15 p.m.

All Seminars:

Bellefield Conference Center

Bellefield Office Park

1150 - 114th Avenue SE

Bellevue, WA 98004

2 hours CE: Call us to Register.