

Income in Respect of a Decedent

Some assets transferred to heirs do not receive a stepped-up basis. This "income in respect of a decedent" is defined as gross income "not properly includable in computing [decedent's] taxable income for the taxable year ending with the date of his death." Reg. 1.691(a)-1(b). IRD assets are those in which there is either untaxed ordinary income or a deferral of capital gain. When the beneficiary receives the asset, the beneficiary is subject to taxation on the asset, just as the original owner would have been subject to such taxation if he or she had recognized the income or gain.

Common IRD assets include IRAs and pension plans, the ordinary element within a commercial annuity, stock options, unqualified deferred compensation, the gain in installment notes and the ordinary element within U.S. savings bonds.

Bequest of IRD

IRD assets are an excellent choice for transfer to charities. While the IRD asset may have been a very desirable asset for the decedent, given a choice, the heirs would far prefer a capital asset to an IRD asset. The capital asset receives a stepped-up basis and the heir may convert the capital asset to cash with no recognition of capital gain. However, upon recognizing the ordinary income or capital gain in the IRD asset, the heir will be subject to tax. Thus, it is eminently logical to transfer capital assets such as stock or land to heirs and use IRD assets for charitable transfers.

When the IRD asset is transferred to charity, the exempt charity will receive the asset without payment of income tax. The IRD asset is a passive asset and thus generates no unrelated business taxable income. [Sec. 512](#). In addition, the transfer to a charity qualifies for an estate tax charitable deduction. [Sec. 2055\(a\)](#).

Transfer of IRD Assets

IRD assets are frequently transferred through a beneficiary designation. A custodian or trustee administers the IRA or pension plan. This is in essence a contractual relationship. In the contract between the IRA owner and the custodian, there will be an opportunity for a beneficiary designation. Normally, it is possible to select both a primary beneficiary and a contingent beneficiary. When the IRA owner passes away, the transfer is not made under the terms of the will of the decedent, but rather in accordance with the beneficiary designation in the contract.

Pension plans and commercial annuities also may be transferred through a beneficiary designation. Savings bonds can be transferred through a pay-on-death provision. In addition, the estate may receive options, installment notes and other types of IRD.

If distributions are made to charity from the probate estate, it is very beneficial to have an allocation provision that permits the executor to use the IRD in satisfaction of charitable bequests. However, caution should be exercised not to require use of IRD assets for pecuniary bequests, since satisfying a pecuniary bequest with IRD could trigger recognition of ordinary income at the estate level. For help with this issue, contact the Wordell Law Group at www.WordellLaw.com.

