**Renewal commissions and other income items as gifts to charity at death**
Leimberg, Stephan R;Huber, Melvyn Jay
*Journal of the American Society of CLU & ChFC;* Jul 1993; 47, 4; ProQuest Central
pg. 80

# Renewal Commissions and Other Income Items as Gifts to Charity at Death

**STEPHAN R. LEIMBERG, J.D., CLU**
**MELVYN JAY HUBER, ESQ.**

**Abstract:** *At a life insurance agent's death, the vested renewal commission asset is subjected to multiple tax liabilities, presents liquidity and valuation problems, and is difficult and expensive for the decedent's personal representative to administer. The authors explain how by bequeathing renewal commissions to a qualified charity (educational, religious, etc.) the problems are greatly mitigated inasmuch as the administrative burden will pass to the charity and the tax and valuation issues disappear. This article also refers to other somewhat similar assets, such as qualified or nonqualified plan death benefits, which are also subjected to multiple tax liabilities. Examples in the article demonstrate how making them payable to a charity at death avoids the taxes.*

This article will explain the problems inherent in the receipt at death of an insurance agent's renewal commissions and other similar items. It will also detail the unique opportunities currently allowed where the otherwise problematic property right is left to a qualified charity, either outright or through a charitable remainder trust.

During an agent's lifetime, the life insurance renewal commission account provides a stream of income to increase his or her standard of living in good times and offers a source of financial stability in economic downturns. It also serves as a significant personal balance sheet asset for credit purposes.

When an agent dies, however, that same renewal account becomes a difficult and troublesome estate asset. Any nonvested portion is, by definition, forfeited. The vested portion's value declines severely and presents substantial problems involving mechanics of allocation and distribution to beneficiaries, valuation, liquidity, and principal and income accounting. Furthermore, the financial security represented by the renewal commission account asset is subject to deterioration by both the federal estate and income tax (with some offset because of its characterization as income in respect of a decedent, often called "IRD" or "Section 691 Income").

When the agent has placed all or most of his or her insurance with one or two large insurers, generally those companies can furnish to the agent's personal representative the date of death values to be used for accounting and estate tax purposes. However, where some or all of the agent's sales were through smaller companies or the agent placed modest amounts of business with a number of carriers, the most that the personal representative may be able to obtain is a listing of policies in force together with such information as issue dates and premium amounts. Should there be a taxable estate, the value of the renewal commission account will likely be a subject of negotiation with an Internal Revenue Service examiner.

On the other hand, had the same potentially troublesome renewal commissions been bequeathed to a qualified charitable organization, the personal representative need not be concerned with IRS valuation disputes because any value arrived at will also be an amount that qualifies as a charitable deduction. Therefore no estate tax is payable on that asset.

No income tax is payable–either by the estate or by any individual beneficiary of the insurance agent's estate when the renewal commissions are bequeathed to charity–because they do not actually or constructively receive the renewal commission payments. No income or estate tax is payable by the charity because the charity is an exempt organization. (A lifetime gift of renewal commissions to charity would generate a different result. Although the charity would still not be required to pay either a gift or income tax, the donor would be taxable on the income. He or she would, of course, be able to take an itemized deduction, subject to the applicable income tax law limitations on charitable deductions.)

Compared to the diminished amount

*This issue of the Journal went to press in May 1993. The above article reflects the authors' interpretation of the law as of that date.*



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

*Where the decedent is survived by a well-to-do spouse... it is more tax advantageous to utilize qualified plan death benefits in fulfillment of charitable intentions...*

a noncharitable beneficiary would receive after reduction in value because of estate and income taxes as well as administration costs, the charity will receive almost 100 cents on the dollar. Once the personal representative has assigned the right to renewal commissions to the charity, the administrative chores of collecting, record-keeping, accounting, and verification pass from the personal representative to the charity. A charity is far better able to handle such matters than the typical individual beneficiary would be.

A charitable beneficiary will receive essentially all renewal commission amounts, as opposed to the pennies on the dollar an individual beneficiary would receive. In many situations, such as a financially secure surviving spouse or financially successful children, or where the agent leaves no spouse or descendant, it is appropriate to bequeath those small amounts to a charity. The agent may wish to use beneficiary or irrevocable trust-owned life insurance to replace the beneficiary's loss.

## Qualified Plan Benefits

Although not subject to the same problems of allocation and distribution, nor to valuation, liquidity, and accounting problems inherent in the estate administration of renewal commission accounts, qualified plan benefits are also subject to strong forces of federal estate tax and income tax erosion (with some offset for characterization as income in respect of a decedent). As shown below, the noncharitable individual beneficiary would receive much less after reduction in value attributable to estate and income taxes compared with the almost full dollar amount that would pass to charity at death. Where the decedent is survived by a well-to-do spouse, for example, or by financially independent descendants, or not survived by any spouse or descendant, it is more tax advantageous to utilize qualified plan death benefits in fulfillment of charitable intentions than it would be to bequeath to charity such assets as stocks, bonds, cash, or real estate.

## Gold Key Multiplier Effect

A leveraging of value can be gained by high estate tax bracket clients who have both a strong charitable objective and who have death benefits payable under a qualified retirement plan of any type[1] or IRA.[2] The popularity of this concept, which the authors call the "Gold Key Multiplier Effect," was fueled by a recent private letter ruling dealing with an IRA left to a charitable remainder unitrust.[3] This same value leverage is available to life and casualty insurance agents who name a qualified charity as the recipient of renewal commissions at death. (In fact, the technique will work as well for other professionals, such as attorneys and accountants, who, at death, have the right to significant income streams.[4])

The term "Gold Key Multiplier Effect" implies a very special set of tax and non-tax opportunities that multiply the beneficial value of any items of "income in respect of a decedent" (defined in detail below) in accomplishing charitable objectives. This article confines its coverage to testamentary transfers since, as stated above, lifetime transfers are subject to a number of problems not present at death.[5]

Specifically, the Gold Key Multiplier Effect provides a way to make significant charitable gifts at death with no adverse tax or cash flow implications during lifetime and obtain an estate tax charitable deduction that can eliminate all or a significant portion of the federal estate tax. That gift is income tax free to the charitable recipient and can provide a sizable lifetime income for one or more personal beneficiaries.

### Problems Where Gold Key Multiplier Effect Not Used

Roberta Silver, a highly successful life insurance agent who was a top producer for a large life insurance company, died at a time when she had the right to sizable renewal commissions payable upon receipt by the insurer of premiums on policies Roberta sold over a 30-year career. At the time of her death, she also had the right to another substantial stream of dollars, installments payable under her company's qualified retirement plan.

At the time of her death, Roberta was 65 years old, divorced, and a grandparent. Her assets, aside from the renewal commissions and retirement death benefit, place her estate into the 55 percent estate tax bracket. Roberta lived in a state where the estate tax is equal to the federal estate tax credit for death taxes paid to the state. She named her grandchild, who is in a 33 percent combined state and federal income tax bracket, as beneficiary of both her renewal commissions and her pension death benefit.

There are many problems, both practical and tax oriented, associated with these common facts. Tax-wise, the value of the retirement plan benefit to Roberta's grandchild will be much less than she anticipated. This confiscatory four-tier tax is illustrated on the following page.

These figures, which show that even without reduction for administration costs the death benefit is worth only 27 cents on the dollar to Roberta's beneficiary, would be even more shocking if any of the $1,000,000 generation-skipping exemption had already been used, if the amount concerned was larger, or if state death taxes exceeded the federal credit. The beneficiary's net take would be further reduced by any state income and death taxes in a state that taxes retirement benefits.

Three of these four onerous taxes



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

could also affect a life insurance agent's renewal commissions. If a life insurance agent leaves renewal commissions to a grandchild, the present value will be subject to (1) federal estate tax[13] (discussed in detail below), (2) generation-skipping transfer tax, and (3) income tax.

This almost pitiful net result is the crux of the problem: Any type of Section 691 income (essentially income earned but not received by the date of a cash basis taxpayer's death) results in an extremely low net result to the beneficiaries of a high bracket client. The client's family will realize only pennies on the dollar with this type of income.[14] This is why it makes so much sense to leave this type of income to charity. The beneficiaries would have received very little; the charity nets a great deal. In some cases, the small amount that would have been received by the beneficiary was not really needed (e.g., a wealthy surviving spouse or financially successful children) or can be easily offset by insurance in a "Wealth Replacement" trust.

**Capital Punishment by Confiscation**[6]

| **Facts:** | | | |
|---|---|---|---|
| Participant's Age at Assumed Death | | | 65 |
| Value of Participant's Interest in Plan | $2,000,000 | | |
| Participant's Federal Estate Tax Bracket | | | 55.00% |
| GSTT Tax Rate if Applicable | | | 55.00% |
| Remaining Amount of $1,000,000 GSTT Exemption | $1,000,000 | | |
| Assumed Income Tax Rate on Pension Distribution | | | 33.00% |
| Maximum Permissible Annual Retirement Benefit | | $150,000 | |
| Transfer Date | | | x/1993 |
| Section 7520 Rate (Assumed) | | | 7.6% |
| **Results:** | | | |
| Present Value of a $150,000 Life Annuity | | $1,255,461 | |
| Amount Exposed to 15% Excess Accumulations Tax | $744,539 | | |
| Initial Value of Participant's Interest | | $2,000,000 | |
| Loss #1: 15% Excise Tax on $744,539 Excess[7] | | $111,681 | |
| Balance after 15% Excise Tax | | $1,888,319 | |
| Loss # 2: Federal Estate Tax[8] | | $1,038,575 | |
| Balance after Federal Estate Tax | | $849,744 | |
| Loss # 3: Generation Skipping Transfer Tax[9] | | $0 | |
| Balance after GSTT | | $849,744 | |
| Loss # 4: Lump Sum Tax on $961,425 of Income[10] | | $317,270 | |
| Balance after Lump Sum Income Tax | | $532,474 | |
| **Summary** | | | |
| Initial Amount | $2,000,000 | | |
| Total Taxes | $1,467,526 | | |
| Net Amount Available to Heirs | $532,474[11] | | |
| Percent Received | 27%[12] | | |

### Gold Key Multiplier Effect–Phase I Solution

On the other hand, using the Gold Key Multiplier Effect, that is, naming a charity as direct beneficiary of the $2,000,000 of pension proceeds, should generate a federal estate tax charitable deduction of $2,000,000 in this example and effectively eliminate the federal (and in most states the state) death tax entirely.[15] The charity will receive the pension money income tax free.

A life insurance leveraged wealth replacement trust or life insurance owned by the grandchild on Roberta's life could be used to make up the $532,474 net after taxes her grandchild would otherwise have received.[16] This same direct bequest to charity technique could be used with renewal commissions or other income in respect of a decedent items.

### Gold Key Multiplier Effect–Phase II Solution

Some clients will want the clean and simple result of the direct gift at death to charity of retirement distributions, renewal commissions, or other income in respect of a decedent items. Others will want to provide for the financial security of one or more family members in addition to the achievement of charitable objectives.

The following example examines the effects of a death-time transfer of income in respect of a decedent, such as qualified retirement plan proceeds, where the bequest is not made directly to charity but instead is made through a charitable remainder annuity or unitrust (CRT). This latter technique is the Gold Key Multiplier Effect–Phase II:[17]

Assumptions:

- The client has a strong desire to "make a positive difference and leave



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

***Assuming the client names a CRT as the recipient of the pension proceeds at death, neither the estate nor the son will pay any income tax on money received by the CRT.***

a name my children, grandchildren, and great-grandchildren can be proud of." He or she would therefore like to provide a meaningful gift to a specific charity at death, but also would like to provide a "floor" of income for his or her son.

- The client is a participant in a qualified retirement plan, and names a CRT as the beneficiary of his or her $1,000,000 death benefit. Payout from the CRT is 6 percent.
- The client's spouse is deceased (or the client is divorced).
- The client's sole heir is a 45-year-old son. The son's life expectancy is approximately 32 years.[18] The son is in a combined federal and state income tax bracket of 35 percent.
- A lump sum payout is made from the plan.[19]
- The client's estate totals $5,000,000 including the $1,000,000 payment from the plan. Federal estate tax is paid from assets of the estate other than the qualified plan proceeds.
- The appropriate federal discount (Section 7520 rate) is 7.6 percent.
- There is no 15 percent excess accumulations tax.

Compare the results, first without, and then with, the use of the Gold Key Multiplier Effect–Phase II.

*Without:* If the client does nothing and merely leaves the pension proceeds to his or her son, the son will be entitled to take an income tax deduction for the death tax generated by the inclusion of the IRD asset. That income tax deduction, designed to alleviate the potential for double taxation, is discussed in detail below. Essentially, it works like this:

If the $1,000,000 is left by the client directly to the son, the full $1,000,000 will be subject to federal estate tax. The federal estate tax incurred by the estate on $5,000,000 (the total estate) will be $1,691,400.[20] Were the $1,000,000 pension distribution (income in respect of a decedent) not includible, the federal estate tax on $4,000,000 would have been $1,302,600, a difference in federal estate tax of $388,800. This is the amount of additional estate tax generated by the IRD asset and is deductible for income tax purposes.

Since the money is assumed to be taken in a lump sum, in calculating his income tax on the money, the client's son can deduct that amount from the $1,000,000 he receives leaving $611,200 subject to income tax. At a 35 percent combined federal and state income tax bracket, the income tax is $213,920. This leaves the son $786,080 ($1,000,000 - $213,920) of investable dollars (assuming the federal estate tax was paid out of the deceased client's other assets).

Assuming a 6 percent return, the before-tax annual income on $786,080 will be $47,164.80. The son's after-tax annual income would be $30,657.12 [$47,164.80 x (1-.35)]. Over his life expectancy of approximately 32 years, the son will net, after income taxes, a total of $981,027.84 ($30,657.12 x 32) of investable or spendable income. Assuming that income is spent during the son's lifetime but the principal of $786,080 remains intact, that amount, $786,080–less any federal and state death taxes–will pass to the client's grandchildren upon the son's death. Of course, under this scenario, nothing passes to charity.

*With:* Assuming the client names a CRT as the recipient of the pension proceeds at death, neither the estate nor the son will pay any income tax on money received by the CRT. Because of the charitable exemption, neither the charity nor the CRT itself would be liable for income tax–even though the client's son will receive income for life from the trust. Because the CRT receives the entire pension proceeds but pays no income or other tax[21] on the $1,000,000, that entire amount can be invested and provide income for the client's son. Assuming a 6 percent return, $60,000 a year will be generated before income tax and $39,000 a year after tax [$60,000 x (1-.35)] for life will be enjoyed by the client's son. Over the son's life expectancy of about 32 years, this generates $1,248,000 of spendable or investable income, a more than 21 percent increase when compared with no charitable gift.

Had no charitable gift been made, the federal estate tax at the client's death would have been $1,691,400. The contribution of $1,000,000 at death to a charitable remainder annuity trust for the life of a 45-year-old (assuming a 6 percent payout rate)[22] results in a $326,026 deduction as shown on the following page. (An annuity rather than unitrust was selected arbitrarily for this example because of the higher deduction.)

Because the estate tax charitable deduction is $326,026, the federal estate tax savings are $179,314.30 (.55 x $326,026). The estate tax payable drops to $1,512,085 ($1,691,400 - $179,314). This $179,314 can be invested for the benefit of the client's son. At 6 percent, the $179,314 produces $10,758.84 ($179,314 x .06) before taxes each year and $6,993.24 [$10,758.84 x (1-.35)] after taxes. When added to the $39,000 of after-tax income from the charitable remainder trust,[23] the son's spendable income increases to $45,993.

Aggregating this additional after-tax annual $6,993.24 spendable (or investable) income from the federal estate tax savings over the son's 32 year life expectancy totals $223,784. When added to the amount projected to be paid over the same 32 year period from the CRT, it totals $1,471,783.68 ($1,248,000 + $223,783). Compared to a direct gift to the son, this is an increase in spendable (or investable) income of over 50 percent.

At the son's death, the money that otherwise would have been paid in federal estate tax at the client's death, $179,314.30, can pass (after payment



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

**Charitable Remainder Annuity**

| | |
|---|---|
| Transfer Date | 1/1993 |
| Section 7520 Federal Discount Rate | 7.6% |
| Fair Market Value of Trust | $1,000,000 |
| Rate of Annuity | 0.06 |
| Payment Periods in Year | 1 |
| Payments Made at Beginning or End of Period | End |
| Age of Person Whose Life Determines the Term of the Trust | 45 Years |
| Amount of Annual Annuity | $60,000 |
| Annual Percentage Payout | 6.000% |
| Annuity Factor | 11.2329 |
| Payout Frequency Factor | 1.0000 |
| Present Value of Annuity | $673,974 |
| Charitable Remainder = FMV of Trust Less PV of Annuity | $326,026 |
| Charitable Deduction for Remainder Interest | $326,026 |
| Donor's Deduction as Percentage of Amount Transferred | 32.6% |

of federal estate tax) to the client's grandchildren. Under this scenario, $1,000,000 passes to charity upon the client's son's death and thus accomplishes the client's objective of making a meaningful and significant gift.

Insuring the life of the son with a policy owned by and payable to a wealth replacement trust for the benefit of the grandson could inexpensively make up the relatively small difference between what the grandchild would have received from the pension distribution had no planning been done and the dramatic increase in benefits to both the son and to the charity through the Gold Key Multiplier Effect.

The illustrations above show that pension accumulations and other such items paid after a client's death provide relatively little value to his or her intended heirs, especially when compared with the advantages of making a direct or indirect gift to a qualified charity. The problem and relative comparison is even more dramatic with respect to the renewal commissions of a life insurance agent.

### Why Renewal Commissions May Be Worth Much Less Than Anticipated

The present value of existing business, work-in-progress which may result in business, and future business from existing clients (e.g., benefit plan increases, potential term conversions, referrals, and repeat sales) are all elements in valuing an insurance agent's practice for federal estate tax purposes.[24] Of these, vested renewals generally will be by far the largest and most important element.[25]

The value of renewals is their fair market value, i.e., the price at which the right to receive them would change hands between two parties, a willing buyer and a willing seller, neither of whom was under any compulsion to execute the hypothetical transaction and both of whom had knowledge of the relevant facts.

There is presently no active market for renewal commissions of life insurance agents, nor is there a uniform company-to-company practice of valuing a "book of business." It is quite possible, therefore, that the estate tax value of an agent's renewal rights could vary considerably from insurance company to insurance company depending on the arbitrary factors used in the valuation process. An individual agent will have little if any input into this process. Of course, his or her survivors will have even less influence. A knowledgeable executor or counsel may have influence on the final IRS determination of value. On the other hand, many life companies will not provide valuation information or calculations, especially if the deceased agent had a small block of business in force.

When valuing renewal commissions, each insurance company that provides valuation information will (1) compute the present value of post-death payments using an appropriate interest (discount) rate, and (2) consider the probability of receipt and make an appropriate adjustment for "persistency." There will almost certainly be a wide disparity, however, between the figure the company derives and provides for IRS federal estate tax reporting and the actual present value of the amount realized by survivors. Survivors could conceivably pay tax on thousands or even millions of dollars of anticipated receivables that are never received.

The lower the discount rate assumed, the higher the value of the renewals. For instance, assume for simplicity that at an agent's death, his or her survivors will receive an income stream of $100,000 a year for 10 years. If one insurer uses a 5 percent discount rate, the renewals will be worth $772,173. If another assumes a 10 percent rate, the same renewals will be valued at only $614,457. Neither the agent nor the survivor has any voice in what discount rate is used in reporting the value of future renewals to the IRS. As to persistency, the company will often apply the persistency table it determines most closely represents the historical lapse rates of the



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

*Persistency... is the single most important factor in the valuation process.*

agent or agency rather than that of the company as a whole.

As a practical matter, most recipients of insurance company statements on the present value of renewal commissions have no way to verify the accuracy of the reported figure. If an insurance company clerk makes a mistake and values the block of business at twice what it is actually worth, an outrageous tax liability will ensue. The legal and actuarial cost to challenge (or even check) the insurer's assumptions or methods could be overwhelming or disproportionate to the potential savings.

Aside from the tax aspects, real world considerations significantly lower the true value of renewals (or for that matter other IRD items) to the survivors. Persistency is the expectation of continuation of renewal premium cash flow and is the single most important factor in the valuation process. Yet the fact that persistency will almost certainly deteriorate at the death of the agent is seldom considered in either the estate tax valuation of renewals or in the agent's own family financial security planning. Few companies (or agents) have measured the statistical impact of death on persistency and therefore have not discounted the "living persistency" figures for the impact of the loss of the agent on lapses.[26]

Renewals may be worth significantly less to the heirs than expected and far less than they are valued for federal and state death tax purposes. One author suggests that even agents who have established a business worth millions of dollars cannot count on their survivors receiving much more than 10 cents on the dollar for their lifetime of effort.[27] There are a number of reasons for these conclusions.[28] Consider what happens to the real value of renewals to an agent's survivors when:

- the policy is paid up (or the premium "vanishes")[29]
- the insured dies[30]
- the insured becomes disabled and premiums are waived
- persistency significantly deteriorates at the agent's death[31]
- the company itself becomes insolvent[32]
- bad publicity causes an adverse reaction to the public's perception of a company's financial health
- the insurer is forced to reduce commissions on existing business to avoid insolvency or to become more competitive
- the insurer sells the entire block of business to another insurer for any reason
- the insurer is purchased by new owners
- there are charge-backs on first year lapses; commissions paid to the estate or survivor are called back because of a policy lapse
- the insurer's (or general agent's) "orphan policyowner" procedures are changed in a way that adversely impacts on servicing and policy retention
- tax law, upon which the sale of the policy was based, changes and diminishes the attractiveness or utility of the contract to the policyowner[33]
- competition increases the likelihood of replacement
- new products make older contracts less attractive or obsolete
- the trend for persistency of universal, variable, and other new products turns out to be much lower than traditional contracts
- the renewal account consists of policies on the lives of relatively few insureds as opposed to many different lives.

**Erosion of $100,000's Purchasing Power Due Solely to Inflation**

| Time Period (in Years) | Assumed Annual Rate of Inflation 0.010 | 0.020 | 0.030 | 0.040 | 0.050 |
|---|---|---|---|---|---|
| 1 | $99,010 | $98,039 | $97,087 | $96,154 | $95,238 |
| 5 | $95,147 | $90,573 | $86,261 | $82,193 | $78,353 |
| 10 | $90,529 | $82,035 | $74,409 | $67,556 | $61,391 |

These are not the only reasons, however. Inflation, too, is likely to reduce the value of renewals.

Unless there are family members licensed to service clients, survivors cannot control renewal accounts or synchronize their income needs with renewal cash flow. Nor are the survivors equipped to check on the insurer and keep track of which policies have, or have not, been paid. The bottom line is that the survivors are at the mercy of the insurer's integrity, administrative capacity, and ability to pay.[34]

A charity to whom those same renewals have been bequeathed is much more likely to receive the full amount, particularly if that charity establishes tracking and accounting systems and has enough renewal commissions coming in from a number of agents to justify the creation and maintenance of such a system. The family of an agent who bequeaths his or her renewal commissions to a charity is giving up less than it may appear, and even that relatively small amount can be replaced with insurance owned either by adult family members or by an irrevocable trust for the family.

### IRD Defined

The major premise of this article is that a survivor will obtain a surprisingly low benefit from items considered income in respect of a decedent.



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

Essentially, IRD is income that would have been taxed to the decedent, had he or she lived long enough to collect it, and instead will be taxed to some other party upon receipt.[35] IRD is simultaneously an asset of the estate, i.e., a property right, and an element of income received by or through a decedent's estate or directly by one or more persons or parties. There is no separation of the asset from the income because the asset essentially is the income in the form of a receivable.

### IRD–The Congressional Purpose Behind It

Code Section 691, "Income in Respect of Decedents," governs the treatment of income and deduction items that were not reported on an individual's return prior to his or her death.[36] Section 691 determines (a) who is to bear the burden of the income tax and (b) when that income tax will be imposed. Under Section 691, tax on income that would have been reportable by the decedent, had he or she lived and received the money, is levied upon the actual recipient at the time of receipt. So the tax is neither avoided nor deferred. Were it not for Section 691, when a person died, the basis of unrecognized gain on a decedent's income earned but not received prior to death would be stepped up to its fair market value and the tax on the gain could be avoided forever. Section 691 thwarts that step-up. If income would have been taxable as income to the decedent had he or she lived and received it, death will not protect it from taxation.[37] Section 691 supports the Section 61 goal of taxing all income from whatever source by preventing the avoidance of income tax through the death of the recipient.

The three major objectives of Section 691 are:

(1) determine who pays the income tax on IRD;

(2) determine when income tax is paid on IRD;

(3) deny a step-up in basis for IRD.

### Who Is Taxed on Income in Respect of a Decedent?

Income in respect of a decedent is reportable in the tax year received (whether or not the recipient uses the cash or accrual method of accounting).[38]

Three parties are potentially taxable on IRD: (1) a decedent's estate, (2) a distributee of estate assets, or (3) the direct recipient of IRD payable because of the decedent's death.

If the decedent's estate acquired the right to receive the IRD, the decedent's estate is taxable.[39] For instance, the right to pension proceeds or renewal commissions or some other IRD paid directly to the executor or administrator of a person's estate results in tax liability for the estate.

If a person or party acquires the right to the income because of a bequest, devise, or inheritance and that amount or right is received after distribution by the decedent's estate,[40] that distributee is taxable. If a decedent's will provided a specific bequest of pension proceeds or renewal commissions and that receivable was distributed by the executor to the heir, that distributee rather than the estate is taxable as income is received. Likewise, if a residuary legatee obtained the right to IRD, the income is taxable to that person rather than the estate.[41]

A third possibility is that some person or party acquires the right from the decedent and receives it directly by contract or operation of law.[42] So if a person or party is the "recipient by reason of death," e.g., the direct or indirect beneficiary of pension proceeds, renewal commissions, or some other IRD, he, she, or it becomes taxable upon receipt of the income item. However, when a qualified charity is the recipient, because it is exempt from income tax as a general rule, it should not incur any IRD liability.

IRD tax liability shifts to the ultimate recipient no matter how many recipients there are and even if there are successive transfers by death.[43] For instance, Sonny B. No inherited the right to receive renewal commissions on life insurance sold by his father, Un, before Un No's death. Sunny inherited the right from his mother, Oh No, who acquired it by bequest from her husband, Un No. Since the renewals were not received during Un No's life, his executor did not include them in his final income tax return. Renewal commissions actually received by Oh No, the mother, were includable in her gross income but renewals received by Sonny were includable in his return.[44]

### When Is Income in Respect Of a Decedent Taxable?

As was mentioned above, the second major purpose of Section 691 is to determine when IRD will be taxable. Two concepts are important to an understanding of how the statute works in this regard: (1) the taxable year concept and (2) the right to receive income.

When a person dies, his or her personal representative must file an income tax return for the period ranging from the beginning of the taxable year to the date of the decedent's death.[45] Additional income tax returns must then be filed on behalf of the decedent's estate for each tax year until the estate is wound up.

Marvelous Melba, a calendar-year taxpayer, died on July 4 of this year. Her executor is required to file a return for her covering the period January 1 to July 4. This is the last return of the decedent. If Melba's estate reports on a calendar-year basis, her executor must also file an income tax return for the estate for the period of July 5 to December 31. A further return will be required for each subsequent year until the estate is wound up.

If, at the time of the decedent's death, the taxpayer is owed certain



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

*The character of the income when IRD is received remains the same as it would have been had the income been received and reported by the decedent . . .*

amounts of income that have not yet been received, it is not appropriate to include such amounts in the final return of the decedent. It is unfair to tax the decedent on income neither actually nor constructively received. Furthermore, if that income is payable over a number of years (e.g., retirement plan distributions or renewal commissions), it would impose an undue hardship to tax either the decedent or the decedent's estate or other recipient on the entire amount all at one time. Such a tactic would bunch income into a tax bracket that might be considerably higher than the rate to which it would have been subjected had it been received over a number of years.

The provisions of Code Section 691 override general provisions that usually trigger taxation at distribution. For instance, in one case a legatee was required to report the full amount of post-death installments of lifetime bonus awards and post-mortem bonuses in the year he received them rather than when the right to receive the bonuses was transferred to him by the estate.[46] IRD is reportable as it is *actually* received by the estate or other recipient rather than at the time the right to receive it is distributed. Taxable year of receipt is therefore the key point of focus and actual collection of the receivable is the triggering event.[47]

### How Much Is Taxable?

If Section 691 applies, the entire amount received (i.e., the value of all cash and property paid to the recipient) is taxable. If the amount is paid in full, it will usually be the sum of all receivables.

### What Happens to the Character of the Income?

The character of the income when IRD is received remains the same as it would have been had the income been received and reported by the decedent (or in the case of successive decedents, by the original decedent).[48] So if it would have been capital gain to the decedent, it remains capital gain to the recipient. If it would have been tax-exempt, it remains tax-exempt. Most IRD would have been ordinary income and that character is not changed by the death of the decedent.

However, although for purposes of characterizing the income IRD is considered to have been acquired by the actual recipient in the transaction from which the item was derived (even where the recipient is a qualified charity), items of IRD received by a charity should be income tax free.[49]

### What Is Considered Income in Respect of a Decedent?

Any compensation received by one or more persons or parties after the death of a cash-method taxpayer for services rendered by that person during lifetime is income in respect of a decedent. The IRS takes the position that the deceased is not required to have to have had a legally enforceable right to receive the compensation in order for the post-death payment to be classified as IRD and the courts seem to agree.[50]

As noted above, federal estate tax inclusion is not a prerequisite to Section 691 classification. Even estate tax excludable[51] post-death benefits, such as payments under a DBO (Death Benefit Only)[52] paid to a decedent's heirs or estate upon his or her death, are income in respect of a decedent if the evidence shows a substantial certainty that the benefits are directly related to the decedent's past economic activities.[53] IRD classification may be attached even if there was no legally enforceable obligation for the employer to make the payments.[54] According to current IRS reasoning, voluntary payments by an employer to the estate of a deceased employee are considered IRD because the payments are in the nature of a payment for services performed for the employer.[55]

Three common types of IRD are compensation, investment income, and sales proceeds. Other common examples are damage claims, alimony arrears, medical reimbursement rights, and trust or estate income distributed to a beneficiary after the beneficiary's death.

### Is Qualified Retirement Money or IRA Cash Considered IRD?

Joint and survivor annuities are IRD.[56] Post-death proceeds from a qualified pension or profit-sharing plan have been held to be IRD.[57] Two IRS rulings clearly confirm that IRA money is includable in the gross estate and reportable as IRD. In the first ruling[58] a decedent named his wife as beneficiary of his IRA.

If his wife were to die before receiving the entire amount, any remaining installments were payable to their three children. His estate claimed a marital deduction for the IRA under the QTIP rules. The request for the first ruling asked the IRS to explain the tax treatment of amounts paid from the IRA to the estate of the decedent in order to pay the federal estate tax attributable to the IRA.

The IRS confirmed that:

(1) IRA funds were includable in the gross estate.[59]

(2) Amounts paid from the IRA to the decedent's estate in order to pay the estate taxes attributable to inclusion of the IRA in his estate were income in respect of a decedent in the hands of the estate's beneficiaries.[60]

(3) Distributions to the estate of a deceased employee or to the employee's named beneficiary were IRD.[61]

### Are Renewal Commissions Income in Respect of a Decedent?

Renewal commissions, commonly called "renewals," earned before but payable after the death of an insurance agent, are items of IRD.[62] According to the IRS, the key test is not whether



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

or not the decedent during lifetime had a legally enforceable right to the payment, but rather whether or not there is a "substantial certainty that benefits directly related to the decedent's economic activities will be paid to his heirs or estate upon his death." [63]

It appears many, if not most, courts will side with the IRS in its "personal efforts" test; if the amounts receivable by the decedent's estate or heir were the result of his or her personal efforts, most courts will classify the payment as IRD even if the decedent could never have received it if he or she had lived. For this reason, even DBO[64] payments, which by definition can never be received by the covered employee and were so far from the employee's control that they are estate tax excludable, are nevertheless considered IRD.[65]

### Deduction of Estate Tax Payments

Section 691 income is not only income but also a property right. As the former, it is subject to income taxation in the hands of its recipient. As the latter, it may be subject to federal estate taxation in the estate of a decedent who owned the income and transferred it at death. (As noted above, all Section 691 income is subject to the income tax, but some Section 691 income is not subject to the federal estate tax).

When 691 income is subject to the federal estate tax, an income tax deduction is allowed for a portion of the federal estate tax generated by Section 691 items. This deduction may be taken on the return of the party who includes Section 691 items in income (typically as an itemized deduction).[66] Although the deduction is considered a miscellaneous itemized deduction, it is not subject to the two percent limit.

The purpose of this income tax deduction (note that it is not a credit) is to minimize the unfairness of double taxation. (As noted above, IRD is typically subjected to both the federal estate tax[67] and to income tax when received by the estate or other recipient.)

Assume that Marvelous Melba, a successful insurance agent, earned and collected a $100,000 commission during the last year of her life, and it increased her income tax liability by $30,000. Upon her death, only $70,000 would have been subjected to estate tax liability since the $30,000 income tax liability would have been considered an estate tax deductible claim against Melba's gross estate. This would in turn have reduced her estate's federal death tax exposure by $30,000.

Had Melba earned but not collected the $100,000 commission by the date of her death, when the commission was received by her only heir, Toasta, the $30,000 income tax liability would still have to be paid. But it would not be allowed as a deduction on Melba's estate tax return since she didn't owe it at her death. The result would be that the full $100,000 would be included in her estate and taxed for estate tax purposes. At a 50 percent rate, her estate would be liable for $15,000 more in tax (.50 x $30,000) than if she had received the commissions before she died.

The purpose of the income tax deduction for income in respect of a decedent is to minimize the obvious hardships in the second of these two instances. This objective is accomplished by allowing the recipient who reports IRD to deduct the amount of federal estate tax which was paid because of its inclusion in the decedent's estate. The deduction is allowed on the income tax return of the recipient for the taxable year in which the Section 691 income is collected.

The deduction is computed by comparing the federal estate tax liability if the IRD is included in the gross estate with the estate tax if the IRD were not included. The result will be an income tax deduction for the attributable estate tax computed at the highest marginal estate tax rate. That formula is:

Federal Estate Tax Payable
(691 Income Included)

minus

Federal Estate Tax Payable
(691 Income Excluded)

equals

Allowable Income Tax Deduction

Assuming there is only one IRD recipient, the entire deduction is taken by that estate or person. Where there is more than one recipient and/or the amounts will be received in more than one tax year, the total deduction is apportioned among the various recipients and/or into the appropriate periods.

To compute the amount allowable as a deduction by a given recipient in any years:[68]

(1) List Total 691 Deduction ______

(2) List Amount Includible in Gross Income ______

(3) List Total Value of All Includible IRD ______

(4) Divide # 2 by # 3 ______

(5) Multiply #4 by # 1 ______

For instance, Magnificent Mable, a successful insurance agent died in 1992. Mable's beneficiary will be paid level renewal amounts of $10,000 a year for five years, a total of $50,000. (For simplicity, the normal decline in renewal payments is ignored.) Assume the federal estate tax present value of that stream of income is $35,000 and that the additional estate tax attributable to 691 items is $15,000. Multiply $15,000 by this fraction: $10,000 (amount includible in gross income)/$50,000 (total value of all includible IRD). One-fifth of $15,000 would be $3,000, so $3,000 of each $10,000 would be deductible.[69]



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

*As is the case with a qualified charity, a charitable remainder trust is normally exempt from income tax.*

In the case of a Gold Key Multiplier Effect–Phase II, where the IRD is payable to a charitable remainder trust and the estate tax charitable deduction will be less than the value of the property in the estate, there will be an estate tax payable on the difference. In some cases the estate tax will be significant. Will the beneficiary be able to take an income tax deduction under 691(c) for the estate tax generated? Is the CRT income considered IRD to its noncharitable beneficiary or is the income tax deduction wasted? It is the authors' opinion that the IRS will attempt to deny a pass-through of the deduction for all or most of the amount received by the income beneficiary.

**Implications to Charity of Receipt of IRD**

Commentary above has focused on the factors that diminish the financial security provided by income in respect of a decedent items to heirs and the relative advantage of a gift either directly or through a charitable remainder annuity or unitrust. But the advantage would be illusory if the charity itself were taxable. Fortunately, such is not the case. Direct receipt by a charity of IRD, such as pension or profit-sharing plan death benefits, will escape income taxation through the charity's exemption from income tax.[70] Nor would such death benefits be taxed in the final return of the decedent since there have been no payments of any income to that person during lifetime. So there are no adverse income tax implications to either the charity or to the donor's estate of naming a charity as direct beneficiary of pension or IRA proceeds, renewals, or other such items.

**Implications to CRT Of Receipt of IRD**

As is the case with a qualified charity, a charitable remainder trust is normally exempt from income tax.[71] The income beneficiary of a CRT is taxable on trust income and gains only to the extent such dollars are distributed to the beneficiary as part of the trust's required "income" payments. Usually, income paid out to the income beneficiary from the trust retains the character it had when the trust earned it because of the conduit rules.[72]

**Can There Be Both an Estate Tax Deduction and a Charitable Exclusion?**

The technique of naming a charity as direct testamentary beneficiary of pension proceeds, renewal commissions, and/or other items of IRD can result in a federal estate tax deduction to the decedent's estate, a tax free receipt of the cash by the charity, and no adverse tax implications to the decedent's estate. Consider the co-existing features of the same transfer: The "asset" aspect of the IRD is an appropriate subject for an estate tax charitable deduction while the "income" aspect of the property is exempt in the hands of a qualified charitable recipient. There is no reason for the IRS to deny either benefit.

Likewise, in a Gold-Key Multiplier Effect–Phase II transaction where the pension or renewal commission is left to a CRT, both benefits (an estate tax deduction to the donor's estate and income tax free receipt by the trust) should be allowed. Because the charity's interest is not total, the estate tax deduction is limited to the present value of the charity's interest. For instance, in the example above where the decedent establishes a testamentary charitable remainder annuity trust for his 45-year-old son, the deduction for the charity's remainder interest was $326,026, about 33 percent of the $1,000,000 paid into the trust when the client died. The balance not eligible for a federal estate tax charitable deduction will be subject to federal estate tax.

The lower the present value of the income payable to the noncharitable beneficiary of the CRT, the larger the charity's interest and therefore the larger the estate tax deduction and lower the federal estate tax. When the noncharitable beneficiary receives a payout with a high present value, the charity's interest is reduced, the charitable deduction is reduced, and the federal estate tax liability on the transfer is, therefore, increased.

In one case where the taxpayer attempted to gain both an estate tax charitable deduction and a deduction from the income tax of the estate, a double deduction was disallowed. In that case there was a charitable bequest of an asset followed by the transfer to the charity of the income earned by that asset while in the estate's hands during administration. The court held that where the asset and the income that the asset generates can be segmented, the charitable deduction will be limited to the amount represented by the subject of the charitable bequest, i.e., the asset. Even though the estate will be allowed an income tax deduction if the decedent's will or trust required that the bequest be satisfied at least to some extent out of income, the total amount of both the estate and income tax deductions is limited to the amount of the bequest.[73]

The Gold Key Multiplier Effect is different: It obtains an estate tax deduction and an income tax exemption for the charitable entity receiving the IRD. The estate receives no IRD under the Gold Key Multiplier Effect and thus should have no income tax exposure. The estate is not involved in the collection or distribution of income in any way. Instead, the estate distributes (if anything) the IRD asset to the charity. Since the taxpayer liable under Section 691 is the entity having the right to it as a result of owning the asset, it is the tax exempt charity that is the real recipient of the income.[74]

In other words, all the statutory framework relied upon by the court which disallowed the double deduc-



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

tion has no bearing on the treatment of IRD. These provisions (Code Sections 642(c), 661, and 662) concern only income earned while the assets are held in the hands of the estate and then distributed to the ultimate recipient. The Gold Key Multiplier Effect provides that the charity is the direct or (through a CRT) indirect beneficiary and the estate neither receives nor distributes any income.

The estate should not incur income tax liability if it receives IRD prior to its transfer of the IRD asset to a charity. (See next section). Can the IRS now argue that the estate can't have both an estate tax charitable deduction and an income tax deduction for the income later paid over to charity? In the authors' opinion, both the estate tax charitable deduction and an income tax charitable deduction should be allowed. The question presented is whether, where the estate receives some or all of the actual income payments prior to its distribution of the right to such income (the IRD asset), the allowance to the estate of a deduction under Section 642(c) based upon the estate's distribution of the income to charity would interfere with the functioning of the 691 rules. It appears that there is no improper avoidance of income tax. This is merely a situation of a testator bequeathing assets to a charity (similar to a transfer to charity of accounts receivable).

### Implications to Estate of Charity's Receipt of IRD

A decedent's estate is, of course, a separate entity subject to income tax. But since nowhere in the Gold Key Multiplier Effect (Phase I or II) is the estate a party and because it receives no IRD, there should be no income at the estate level.

An estate's charitable contributions are deducted, if at all, under the provision dealing with the charitable deductions of trusts and estates, not as distributions to a beneficiary. An amount credited or required to be distributed in a given tax year, and therefore deductible for that year, may not be claimed as a distribution deduction in a later year of actual payment.

The distribution deduction of a decedent's estate is the sum of:[75]

(1) Income required to be distributed currently during the tax year, regardless of amount. This even encompasses an annuity payable out of income or corpus to the extent it is paid out of income and;

(2) Other amounts (regardless of whether considered income or corpus) to the extent properly paid or credited or required to be distributed during the tax year.

This sum specifically excludes (a) lump-sum gifts or bequests and (b) charitable contributions.[76]

If, for whatever reason, the estate receives one or more installments of either pension or renewal payments bequeathed to charity and then turns that money as well as the right to the remaining IRD over to the charity, it will first report the income and then take an income tax charitable deduction.[77]

As noted above, the estate cannot receive both the income tax charitable deduction and the deduction allowed for distributions it makes to beneficiaries. An estate's income tax charitable deduction for amounts paid to (or set aside for) charity is limited to disbursements of income only.[78] Furthermore, the deduction for charitable distributions is allowed only to the extent that it is paid out of gross income in accordance with the charitable deduction provision.[79]

Payments of estate corpus are not deductible for income tax purposes. This limitation can't be avoided by claiming a distributions deduction. For instance, in one case where an estate distributed corpus to charity and claimed a distributions deduction after being allowed an estate tax charitable deduction for the same distribution, the second deduction was disallowed. In spite of the fact that the Code seems to allow such a double deduction,[80] it is clear neither the IRS nor the courts will allow it.[81]

### Potential Impediments with Respect to Transfers of Qualified Retirement Plan Death Benefits

Not everyone will be able to assign qualified plan or IRA death benefits to a charity, even if such a course of action is otherwise appealing and tax advantageous. The Retirement Equity Act of 1984 (REA) requires that (with limited exceptions) the covered employee's spouse consent in writing to any beneficiary designations that name someone other than that spouse as the primary beneficiary of some or all of any death benefits.

The accrued benefit of a married employee whose benefit is vested, who has been married for at least one year at death, and who dies prior to the annuity starting date must be paid as a "qualified preretirement survivor annuity," a survivor annuity payable for as long as the surviving spouse lives.[82] These rules may not be circumvented solely through a premarital or post-marital agreement.[83]

Widows, widowers, divorcees, and other single individuals will not be troubled by this restriction. Even married individuals may want to consider naming a charity as a secondary beneficiary of retirement plan death benefits.

In some cases a spouse will waive, in writing, the right to the annuity. The waiver should specify the charity or charities to which the retirement benefits are to be paid. Once made, the charitable beneficiary generally cannot be changed without the spouse's consent.[84]

### Potential Impediments with Respect to Payment of Renewal Commissions to Charity at Death

Some states will not allow an agent to specify during lifetime by contract



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

*Some agent contracts allow the designation of one or more specific beneficiaries to receive renewal commissions payable after the producer's death.*

with the insurer the recipient of renewal commissions. For instance, neither Pennsylvania nor New Jersey allow the contractual designation of a beneficiary other than the estate of the agent. In such states the gift to charity of renewal commissions must be made by will. Some states do allow an agent to specify the person or persons to receive renewals after death.

### Beware of Specific Dollar (So-called Pecuniary) Bequests to Charity

If a specific bequest of an IRD item is made to charity of a certain dollar amount (e.g., $100,000) and the executor chooses to satisfy that bequest through the assignment of retirement plan death proceeds, renewal commissions, or other IRD items payable to the estate, this distribution in satisfaction of the pecuniary gift will trigger what may be a serious tax problem: the estate must realize taxable gain in the amount by which the date of distribution value of the property exceeds its estate tax value.[85] The present value of all future payments would be recognized immediately as income at the time the estate made a transfer of the right to the money to charity. On the other hand, a specific bequest gift of "renewal commissions paid after my death" would avoid this problem.

### Mechanics of Bequests of Renewal Commissions to Charity upon Death

The three methods by which renewals can be passed to charity upon death are: (1) by will, (2) by contract, and (3) by a trust.[86]

An outright bequest by will vests title in the charity outright. Whether renewals are left by contract designation or by bequest, the renewal account is subject to creditors' claims.[87]

Some agent contracts allow the designation of one or more specific beneficiaries to receive renewal commissions payable after the producer's death. These contracts may, or may not, allow someone other than "the same classes as provided in the life insurance policies of the series issued by the company on the date of this agreement." In other words, the insurer may insist on limiting the class of beneficiary that an agent can choose. Absent a choice, or if state law limits the beneficiary designation, the agent's estate usually would be the beneficiary. So the agent would provide for the disposition of renewals either directly to a charity or to a CRT in his or her will.

### Downsides, Costs, and Uncertainties

As with any tool or technique of estate planning, the Gold Key Multiplier Effect is not without downsides, costs, and uncertainties. For instance:

• Not every client can afford to give to charity. Should the agent be survived by a close family member, even the relatively little the family will be giving up–net after taxes and costs–may be too much.

• If the transfer is to a charitable remainder trust, an estate tax liability must still be met.[88] Since the entire burden of federal and state death and death related excise and income taxes on the present value of the income stream retained for the client's noncharitable beneficiary must be shouldered by assets other than those going to the charity, liquidity–through life insurance or some other means–must be readily available. In the case of a pension or IRA death benefit, the 15 percent excess accumulations tax, if applicable, must be paid by the decedent's estate even if the entire amount is paid to charity directly.

• As in all testamentary dispositions, an attorney will be required to draft the appropriate will provisions or trust instruments.

• Valuation of the charity's interest is necessary and may, in some cases, be both difficult and expensive. However, where there is a full immediate bequest to a charity, valuation can be relatively inexpensive and it is probable that the IRS will not engage in a costly valuation dispute inasmuch as the amount at issue would be fully deductible in any event.

• The private letter ruling protecting the taxpayer who made a contribution to a CRT was just that–a letter protecting only that taxpayer in only that situation. This will provide some comfort to others, but lacks the security of a favorable case or revenue ruling. A private letter ruling is an indication of the probable IRS position on a subject but may not be relied upon as a precedent.

### Conclusion

A bequest to charity of an agent's renewal commissions, pension death benefit, or other items of IRD:

• Costs surprisingly little in terms of survivors' financial security

• Avoids adverse income tax consequences

• Eliminates any federal or state income, estate, or generation-skipping tax

• Yields close to 100 cents on the dollar to charity

• Reduces administrative expenses.

The little given up by beneficiaries is far outweighed by the meaningful and significant benefit given to charity. That relatively small cost can easily be offset by a "Wealth Replacement" trust funded with life insurance on the life of the charitable donor.

Where the agent is survived by close family who require support, if the estate has or can obtain liquidity, the income of the beneficiaries can be substantially increased through a contribution to a charitable remainder trust instead of a direct gift to charity. The major cost will be the need to pay up-front federal estate taxes, but the technique will result in a significant



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

# Renewal Commissions and Other Income Items as Gifts to Charity at Death

overall increase in financial security for the client's survivors as well as a large eventual gift to charity.**J**
(I/R Code No. 1600.00/2600.00)

**Stephan R. Leimberg, J.D., CLU, is professor of taxation and estate planning at The American College, Bryn Mawr, Pa., co-author of *Tools and Techniques of Estate Planning, Tools and Techniques of Employee Benefit and Retirement Planning, Corporate Buy-Sell Handbook, Tax Planning with Life Insurance*, and co-creator of NumberCruncher, TOOLKIT, BIZ-KIT, IRS Factors Calculator, and Charitable Giving Sales Solutions Software.**

**Melvyn Jay Huber, Esq., practices law in New York City and Westchester County, New York. Mr. Huber is a member of the *Committee on Estate Planning and Drafting: Pre-Death Planning Issues* of the American Bar Association's Section of Real Property, Probate and Trust Law. He is dean of the Graduate School of Financial Sciences of the New York Center for Financial Studies where he teaches graduate courses in estate planning and business tax planning.**

The authors wish to acknowledge the substantial contribution of Irv E. Geffen, Jewish Federation of Greater Philadelphia.

(1) This includes qualified pension and profit-sharing plans, 401(k) plans, HR-10 (Keogh) plans, and tax-deferred annuities.
(2) If a client makes a transfer of qualified plan or IRA dollars to a charity or charitable remainder trust during lifetime, the income and/or gain that had remained untaxed until the date of the transfer will be taxed at that time to the donor. There is no provision at the current time allowing a tax free rollover of retirement funds to either a charitable remainder trust or even directly to a charity.
(3) PLR 9237020.
(4) Appreciation is expressed to attorneys Lowell H. Dubrow of Wolf, Block, Schorr, & Solis-Choen; Eric Johnson of Haverford, Pa; Thomas Commito, National Life Insurance Company of Vermont; Eugene Gladstone, Provident Mutual Life; and to Paul J. Malagoli, The Equitable; Martin Burke, Michael J. Forni, Gerard L. Ouellette, and Charles E. Giard, MassMutual. The article entitled, *The Benefits of Charitable Remainder Trusts* by Steiner and Wertlieb published in J. of the Am. Soc. of CLU & ChFC, Nov. 1992 at 58, is highly recommended for an overall illustration of the applications and tax benefits of charitable remainder trusts. Messrs. Steiner and Wertlieb anticipated the results of the favorable private letter ruling on bequests to charitable remainder trusts and provide an excellent illustration of the concept's advantages with respect to retirement plan distributions. See also Teitell, *Funding Charitable Remainder Trusts With Innovative Assets*, Trusts and Estates, Jan. 1993, at 53 for a thoughtful and critical analysis of the concept the authors call the Gold Key Multiplier Effect. This concept has also been called the Ultimate Beneficiary Option.
(5) It is clear that a person or party can be subject to tax on income which they never receive but which is received by other persons. See Leimberg, et. al., The Federal Income Tax Law (1993). See also Rev. Rul. 77-346, 1977-2 C.B. 340 and Rev. Rul. 75-448, 1975-2 C.B. 55. Assuming income is taxable, the Code then seeks to tax it to those who earn it or who own or control the property which is the source of the income. The three leading cases in this assignment of income theory, developed entirely through case law, are Lucas v. Earl, 281 U.S. 111 (1930) and Helvering v. Eubank, 311 U.S. 122 (1940), which dealt with the assignment by a husband to his wife of part of his future earnings and part of his earnings from services previously rendered. See also Helvering v. Horst, 311 U.S. 122 (1940), dealing with the transfer by a father to his son of interest coupons detached from bonds shortly before they matured. (Changes to tax law in 1948 removed the incentives for assignments by a spouse to the other spouse.) A taxpayer cannot, therefore, avoid the tax on income by assigning any part of it to another person or entity regardless of whether the income in question was earned by the person's personal services or by income derived from property owned by the taxpayer. The general rule is that the fruit (income) is taxable to the person who owns the tree (the capital asset which produced the income). Merely assigning the fruit (income) will not shift the taxation to the recipient. To shift income tax liability to the assignee, it is necessary to transfer the tree. After a transfer of securities or other income producing asset, income produced by that property from the date of transfer will then be taxed to the new owner. The property transfer must be complete, bona fide, and the transferor may retain no control over either the property or the income it produces. The transfer must be made before the income is actually earned.
(6) This illustration courtesy NumberCruncher Software.
(7) Code Section 4980A(d)(1) imposes a 15 percent excise tax on the "excess retirement accumulation" of an individual. This is defined as the excess, if any, of the value of the decedent's interest in all qualified plans and IRAs over the present value of a single life annuity that would have been payable to the decedent based on the decedent's age at death assuming annuity payments are equal to the "annual excess retirement distribution limit" in effect in the year in which death occurs. This limit is the greater of $150,000 or $112,500 indexed for inflation. (At present, the $150,000 amount is higher.) No credits can be applied against this tax, nor can it be reduced by the marital or charitable deduction or the unified credit. Code Section 691(c)(1)(C) provides that the excess accumulations tax is not deductible (as is the regular federal estate tax) against the income received as IRD. The excess accumulations tax is deferrable if paid to a surviving spouse who receives at least 99 percent of the total retirement accumulation from the decedent. A surviving spouse may elect to have the tax deferred until the surviving spouse's death. IRC Sec. 4980A(d)(5). This deferral presumes the surviving spouse makes an election on the decedent-spouse's estate tax return. When the surviving spouse dies, the amounts deferred at the first death are added to the surviving spouse's own accumulations and subjected to the 15 percent tax. This 15 percent tax is deductible from the gross estate as a debt of the estate. This effectively reduces the impact so that at a 50 percent bracket, the effective rate will be 7.5 percent.
(8) Code Section 2039(a) subjects the lump sum or present value of retirement benefits payable to either named beneficiaries or to the estate of a plan participant to the federal estate tax. There are no longer exclusions for most plan distributions. Failing qualification for either the marital or charitable deduction, the entire amount paid at a plan participant's death will be subjected to the federal estate tax.
(9) The Generation-Skipping Transfer Tax (GSTT) is a flat tax imposed at a rate arbitrarily set as the highest federal estate tax rate. This tax is imposed on transfers of property at death (or during lifetime by gift), generally to grandchildren of the transferor. See Leimberg, et al, Tools and Techniques of Estate Planning, (1993) National Underwriter Company. Every individual is allowed to make aggregate transfers of up to $1,000,000 either during lifetime or at death that will be wholly exempt from the GSTT.
(10) Most of the amount received by a plan participant's beneficiary has never been subject to income tax, a burden which has been merely deferred. Death does not erase the liability. Code



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

المنارة للاستشارات

Sections 72 and 402(a)(1) assure that distributions at death from qualified plans are subject to ordinary income tax as received. Aside from nondeductible participant contributions and amounts already included in income as P.S. 58 costs, in most cases the entire distribution will be taxable. Special tax treatment may be afforded where a lump sum (a distribution of the balance to the credit of a participant taken within one taxable year of the recipient and payable, in this case, as a result of the participant's death) is received. The taxable portion is considered income in respect of a decedent and is therefore generally reportable by the recipient as ordinary income in the year received.

(11) Consider a lifetime payout of amounts subject to the 15 percent excise tax in excess of the "protected amount." The net after-tax proceeds could be given to the intended beneficiaries who could use the gift to purchase life insurance on the life of the donor.

(12) $532,474 net remaining divided by $2,000,000.

(13) Renewals will not qualify automatically for the marital deduction. Without proper planning, a married agent's surviving spouse cannot be assured of receiving federal estate tax free payments. Renewals will not qualify for the deduction where contingent beneficiaries are named to succeed at the death of the surviving spouse. Absent great care, the marital deduction will be lost even where the agent's spouse is named as primary beneficiary. Estate of Raymond Baker, Jr. T.C.M. 1988-483. This case is discussed in detail in Keeping Current, Volume 19, No. 3, June 1989, Pg. 19. See also Zaritsky and Leimberg, Tax Planning With Life Insurance, 1992. Furthermore, many states, such as Pennsylvania, do not provide for a marital deduction under state death tax laws.

(14) Should a spouse be named as recipient of income in respect of a decedent? Planners expecting a marital deduction for an agent's renewals should read Estate of Raymond Baker, Jr. v. Commissioner., 56 T.C.M. 417 (1988) for a "how not to do it" blueprint and Lynch, *Qualifying Renewals for the Marital Deduction: The Baker Case*, 19 Keeping Current No. 3 (June 1989) for steps to assure a deduction. Baker involved a general agent who had signed a contract with the insurer under which payment of renewals was to be made over a 30 year period to his spouse for life and upon her death the decedent's children were given a contingent right to the payments. The surviving spouse did not have a power of appointment over her interest. There was a supplemental form, specifically designed to obtain the marital deduction by giving a spouse the power to appoint the renewal commissions to her estate or some person, but the decedent didn't sign that form. Since no QTIP election was made, the IRS barred the marital deduction on the grounds that the contract resulted in a nondeductible terminable interest. Certainly, a marital deduction would eliminate the federal estate tax, there would be no generation-skipping transfer tax, and the surviving spouse may be able to elect to not have the excess accumulations tax be imposed at the first death. IRC Sec. 4980A(d)(5). This presumes an election is made by the surviving spouse on a form attached to the decedent's federal estate tax return. It can only be made if the spouse is recipient of at least 99 percent of the total retirement accumulation. Then, when the survivor died, the distributions untaxed at the first death would be aggregated with retirement accumulations of the second spouse for purposes of the 15 percent tax. But such a tactic is not always available and often is not desirable even if possible. Some authorities question whether this tax delay can be accomplished if payment is made to a QTIP marital trust rather than outright to the surviving spouse. All planners must also consider the full tax and cash flow ramifications of this delaying tactic. In some cases heirs may find that they would have been better off had the 15 percent tax been paid at the first death. An excellent discussion of this and other elements of planning can be found in Mezzullo, *Income Tax and Estate Planning for Distributions from Qualified Retirement Plans*, 18 ACTEC Notes 30 (1992) and Mezzullo, *An Estate Planner's Guide To Qualified Retirement Plan Benefits, Section of Real Property, Probate, and Trust Law*, American Bar Association (1992).

(15) However, most authorities feel the 15 percent excise tax will not "disappear" merely because the pension was payable to charity. Since it does not, who remains liable to pay it? If the charity is liable to pay the excess accumulations tax, the estate's charitable deduction will probably be decreased and the estate's estate tax liability increased. If the decedent's estate is liable for the 15 percent excise tax, there will be a liquidity need–even after contributing the pension death benefit to charity. Absent a more cost effective alternative, life insurance should be purchased to provide the cash to pay this tax. Where IRD items are bequeathed specifically to charity, they are technically excluded from the gross estate and from the charitable deduction. See Ferguson, Freeland & Stephens, Federal Income Taxation of Estates and Beneficiaries (Little, Brown & Company), and Rev. Rul. 67-242, 1967-2 C.B. 227; Regs Sec. 1.69(d)-1(e), Example 2.

(16) See Zaritsky and Leimberg, Tax Planning With Life Insurance (1992) and Leimberg, et al., Tools and Techniques of Estate Planning (1992) for more information on the wealth replacement concept in charitable planning.

(17) Illustration courtesy Irv. E. Geffen, Jewish Federation of Greater Philadelphia, Endowments Corp. and Lowell Dubrow, of Wolf, Block, Shore, Solis-Cohen. See Teitell, *Funding Charitable Remainder Trusts With Innovative Assets*, Trusts and Estates, Jan. 1993 at 53.

(18) According to NumberCruncher Software, the Section 72 life expectancy of a 45-year-old is 37.7 years while the 80 CNSMT life expectancy is 32.2 years. Mr. Geffen's illustration therefore probably understates the advantages of this technique.

(19) In making the decision as to how qualified plan or IRA benefits should be received, practitioners should consider certain tax law restrictions. If the plan participant dies prior to age 70-1/2, the beneficiary can take payments over his or her lifetime or life expectancy. IRC Sec. 401(a)(9)(b)(iii) and 408(a)(6). If death occurs after age 70-1/2, the beneficiary must take the balance of the IRA as quickly as the decedent-participant had been receiving it. Sec. 401(a)(9)(b)(i) and 408(a)(6). The beneficiary must pay income tax on the entire amount to which he or she is entitled if the plan participant had been recalculating life expectancy year by year. Prop. Treas. Reg. Sec. 1.401(a)(9)-1, Q&A E-8, and 1.408-8, Q&A A-1.

(20) "Estate tax" for purposes of this computation is the gross tax reduced by the unified credit, the credit for state death taxes, the credit for taxes on prior transfers, and the credit for foreign death taxes. For more on this topic, see Acker, 32-3rd T.M., Income in Respect of a Decedent. See also Johnson, Westphal, and Bolling, Estate and Income Tax Implications of IRD, Taxes, Jan. 1993 at 35. The federal estate tax computations in the example are based on a top rate of 50 percent.

(21) See the commentary above on the potential impact of any excise tax levied on pension proceeds. If the 15 percent tax is paid out of money that otherwise would go to charity, that would result in a reduction of the charitable deduction and an increase in estate tax liability in the client's estate. It is both unclear and in the authors' opinion improbable that under current law a Section 691(c) income tax deduction for the 15 percent excess accumulations tax would be allowed.

(22) The illustration, courtesy of Number-



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

# Renewal Commissions and Other Income Items as Gifts to Charity at Death

Cruncher Software, assumes payments once each year at the end of the year and a federal discount rate of 7.6. Obviously, changes in the age of the annuitant, the payout rate, the discount rate, the frequency of payments (more than once each year), and whether payments are made at the beginning or end of a payment period will impact on the size of the estate tax deduction.
(23) Some authorities feel that the income beneficiary of the CRT would be allowed a Code Section 664 pass-through of the trust's Section 691(c) income tax deduction for the IRD (the estate taxable pension proceeds). If this position is correct, the income beneficiary's net after tax income will be higher than projected.
(24) Valuation of Practice, Report of the Professional Practice Continuation Task Force, Submitted to the Executive Committee of the Million Dollar Round Table, (Aug. 1980). For other articles on the valuation of an agent's practice, see Monroe and the Bottom Line Task Force of the 1987 Million Dollar Round Table, Estate Planning for the Agent, (1987); Duryee, *Valuation of an Insurance Agency*, Broker World (Oct. 1988), Rybka, *How Much is a Successful Life Insurance Practice Really Worth?*, Best's Review, Life and Health Edition (March 1980). Rybka claims that there are nine essential elements of value: (1) renewal commissions, (2) service fees, (3) persistency bonuses, (4) production bonuses, (5) cases in progress, (6) repeat sales, (7) benefit plan increases, (8) potential term conversions, and (9) referrals.
(25) Other elements of value may be "overrides," persistency and quality award bonuses, non-vested renewals, fees for service, and for some the value of shares in a producer-owned insurance company or reinsurance company. In many companies, however, service fees and persistency bonuses, which may comprise a significant portion of the income an agent enjoys during lifetime, cease at the death of the agent. This ironic disincentive means less likelihood that the contract will remain in force at the agent's death and is highly costly to both agent and company.
(26) Persistency rates can also vary considerably depending on whether they are based on the industry average, the company or agency average, or the agent's own experience.
(27) Rybka, supra.
(28) See the excellent article by Moyse, *The Valuation of Existing Business in a Life Insurance Practice*, J. of the Am. Soc. of CLU & ChFC, (July 1990) at 66.
(29) For estate tax valuation purposes, it may make a significant difference whether a company uses industry average or company average figures for its termination assumptions.
(30) For federal estate tax valuation purposes, a company will probably have to make certain assumptions as to how soon insureds will die since the premium payment stream on most policies ceases at that point. Does the company use industry assumptions or company experience? Do overall persistency assumptions consider the probability of death or are these figured separately?
(31) This, of course, is expected, but is post-death persistency deterioration computed industry-wide or company-wide in computing the value of the agent's business for federal estate tax valuation purposes? In other words, will the real life experience of survivors be worse than the assumptions made in computing value for estate tax calculations? For instance, the more important the personal relationship of the producer in making and maintaining the policy, the more likely competitors (even within the same company or agency) will replace the business. Perhaps it was the expertise of the deceased agent in a specialized area such as pension planning that resulted in a significant percentage of sales and retention. Will the person who services that business after the agent's death have the same level of expertise?
(32) According to Moyse, at 66, "The typical state insurance solvency law provides that claims for unpaid commissions rank along with the claims of general creditors." That means survivors must wait until liquidator's expenses, certain employee claims, and claims of policyowners have been satisfied before being satisfied.
(33) The phase-out of personal interest deductions, the corporate AMT on death benefits, and the taxation of the internal buildup in annuities owned by non-natural persons are just a few instances of legislative changes that severely impacted upon product sales.
(34) Some agents are shareholder-owners of a corporation providing life insurance services. Assuming agent contracts are in the name of an ongoing corporation and there is a binding buy-sell agreement providing for the purchase of stock at death, the value of the stock would govern for federal estate tax purposes.
(35) See Johnson, Westphal, and Bolling, *Estate and Income Tax Implications of IRD*, Taxes, Jan. 1993 at 35, and Blattmachr and McCarthy, "*What Accountants Should Know About Income in Respect of a Decedent*," The Practical Accountant, June 1992, at 38.
(36) Leimberg, et. al, Federal Income Tax Law (1993).
(37) IRC Sec. 1014.
(38) IRC Sec. 691(a)(1); Reg Sec. 1.691(a)-2(a), Sec. 451(b).
(39) IRC Sec. 691(a)(1)(A).
(40) IRC Sec. 691(a)(1)(C).
(41) IRC Sec. 691(a)(1)(c).
(42) IRC Sec. 691(a)(1)(B).
(43) IRC Sec. 691(a)(2).
(44) Reg Sec. 1.691(a)-2(b), Example (2). See also Treas. Reg. Sec. 1.691(a)-2(b), Ex. 2.
(45) See Plotnick and Leimberg, How to Settle An Estate (1992).
(46) Code Sec. 691 overrides Code Sections 661 and Code 662. See Rollert, Edward Residuary Trust, 80 T.C. 619 (1983), aff'd 752 F2d 1128 (6th Cir. 1985), 55 AFTR 2d 85-685, 85-1 USTC, 85-1 USTC; Dean, Jack Estate, T.C.M. 1983-276. In Rollert, the court held that although the reliance of the petitioner and estate on Section 661-662 conduit provisions was literally correct, it undermined the objective of Section 691, which is to prevent the escape of income tax through the death of the recipient. Any conflict between the IRD rules of Section 691 and the conduit rules of Section 661-662 will be resolved in favor of 691.
(47) An estate is not considered to have "collected" a Section 691 item merely because it transferred the right to receive it to the party entitled to it. The estate of a decedent may transfer the IRD to one or more trusts and the trusts can even transfer the right to others who are beneficiaries under the trust. No taxable event occurs until the IRD is actually collected or subject to a taxable transfer. Reg. Sec. 1.69(a)-4(b).
(48) IRC Sec. 691(a)(3).
(49) Note that a charity is taxable upon unrelated business taxable income, i.e., income unrelated to the purpose for which the charity was granted its exempt status. But it is hard to imagine how a bequest situation involving IRD could be considered a trade or business. Planners should note that using a 691 item as a charitable bequest will result in losing part or all of the 691(c) income tax deduction attributable to the portion of the estate tax liability that it bears because no income should be recognized by the charity. But that loss should be offset by the nonrecognition of income by the decedent's estate or other beneficiary.
(50) The courts frequently agree: Ruth O'Daniel Estate v. Commissioner, 173 F2d 966 (2nd Cir. 1949), 37 AFTR 1249, 49-1 USTC, affg. 10 TC 631; Bausch, William Estate v. Commissioner, (1951, CA2) 186 F2d 313, 40 AFTR 61,51-1 USTC, affg. 14 TC 1433; Claudia Halliday v. United States., 655 F2d 68 (5th Cir. 1981), 48 AFTR 2d 81-5819, 81-2 USTC, revg Birming-



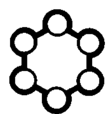
Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

ham Trust National Bank, 46 AFTR 2d 80-5999, 80-2 USTC.
(51) See DiMarco Estate v. Commissioner., 87 T.C. 653 (1987) acq., 1990-2 C.B. 1; Hinze v. United States., 72-1 USTC Para. 12842 (C.D. Cal. 1972).
(52) See Leimberg, et. al. Tools and Techniques of Estate Planning, 9th Edition (1992). Leimberg and McFadden, The Tools and Techniques of Employee Benefit and Retirement Planning (1993).
(53) See Bausch's Estate v. Commissioner, 186 F. 2d 313 (2d Cir. 1951).
(54) Claudia Halliday v. United States, 655 F.2d 68 (5th Cir. 1981), 48 AFTR 2d 81-5819,revg Birmingham Trust National Bank, 46 AFTR 2d 80-5999.
(55) Bausch, William Estate v. Commissioner., 186 F2d 313.
(56) Rev. Rul. 73-327, 1973-2 C.B. 214 and Nilssen Estate v. United States., 322 F. Supp. 260 (D. Minn. 1971). Section 1014(b)(9)(A) denies a step-up in basis at death to such annuities. See Lacomble v. United States, 177 F. Supp. 373 (C.D. Cal. 1959).
(57) Hess v. Commissioner, 271 F.2d 104 (3rd Cir. 1959); PLR 9132021 (dealing with an IRA); and GCM 39858 (which held that both IRA and qualified plan benefits are IRD).
(58) PLR 9132021.
(59) IRC Sec. 2044.
(60) The amounts actually paid to the decedent's estate from the IRA were treated as first distributed to the children and then paid over by them to their father's estate because of their obligation to pay their father's estate and inheritance tax obligations. IRC Sec. 2207A. See also Rev. Rul. 92-47, 1992-26 I.R.B. 6 in which the IRS held that the lump sum received by the decedent's beneficiary from the decedent's IRA (less the amount of the nondeductible contributions made by the decedent) was taxable as income to that recipient under IRC Sec. 408(d)(1) and was IRD because of IRC Sec. 691(a)(1). It is clear under this ruling that both income earned by the IRA and the unrealized appreciation are taxable to the beneficiary (subject to the rollover provisions of IRC Sec. 408(d)(3)(C) allowing a tax-deferred rollover and therefore avoidance of current income taxation if the recipient was the decedent's spouse and the distribution is placed into another IRA). Rev. Rul. 92-47 also confirmed that the beneficiary/recipient of IRD is entitled to take an income tax deduction for the federal estate tax generated by that IRD.
(61) Rev. Rul. 69-297, 1969-1 CB 131; Rev. Rul. 68-506, 1968-2 CB 332; Rev. Rul. 54-601, 1954-2 CB 197; Hess, Lloyd v. Commissioner., 271 F2d 104 (3rd Cir. 1959), 4 AFTR 2d 5638.
(62) Halliday v. United States, 655 F.2nd 68 (5th Cir. 1981). See also Reg. Sec. 1.691(a)-2(b), Ex. 2 in which the decedent's widow was bequeathed the decedent's right to receive insurance renewal commissions. This right was classified in the example as IRD and the commissions were included in the income of the widow. See also Final Report on Estates, Trusts, Beneficiaries, and Decedents From The Advisory Group on Subchapter J of the Internal Revenue Code of 1054 (Dec. 30, 1958) which can be found as Worksheet 10 of Acker, 32-3rd T.M., Income in Respect of a Decedent.
(63) For an extensive analysis of Section 691 and for a criticism of this IRS approach, see Acker, 32-3rd T.M., Income in Respect of a Decedent. See also O'Daniel Estate v. Commissioner., 173 F.2nd 966 (2nd Cir. 1949) and Rollert Residuary Trust v. Commr., 80 T.C. 619 (1983), aff'd, 752 F.2nd 1128 (6th Cir. 1985). Here, a bonus paid voluntarily by an employer more than three months after the employee's death was considered to be income in respect of a decedent even though the decedent had no legally enforceable right to receive it.
(64) See Leimberg, et. al, The Tools and Techniques of Estate Planning and Leimberg and McFadden, The Tools and Techniques of Employee Benefit and Retirement Planning.
(65) This approach appears to be overkill since, if no estate tax inclusion is required, no step-up in basis at death can occur. The prevention of an inappropriate step-up in basis is not necessary.
(66) Rev. Rul. 78-203, 1978-1 C.B. 199.
(67) For exceptions see O'Daniel Estate, 173 F.2nd 966 and PLR 7801001.
(68) This amount is limited to the value of the IRD item for estate tax purposes.
(69) For a more detailed explanation of the allocation of the Section 691(c) deduction, see Acker, 32-3rd T.M., Income in Respect of a Decedent. Planners should note that this allocation of the deduction may or may not be fair when all factors are considered. For instance, one party may bear the entire burden of the federal estate tax because of state law or a tax clause in the decedent's will or trust, while one or more others may receive all or most of the income tax deduction.
(70) IRC Sec. 501.
(71) IRC Sec. 664(c) and Reg. Sec. 1.664-1(a)(i). This assumes the trust receives no unrelated business taxable income.
(72) IRC Sec. 664(b); Reg. Sec. 1.664-1(d).
(73) This seems unfair since the estate will in fact pay all income earned during administration to the charity. The only justification for this harsh position seems to be that the testator made a charitable bequest of only the asset and did not intend to make a gift of the income nor did he or she intend that the estate make such a gift. For whatever reason, where an asset and the income it generates can be bifurcated, the IRS and the courts will view this a charitable gift of the asset and not the income unless the testator's governing instrument clearly provided gifts of both.
(74) Distinguish this from the situation in United States Trust in which the estate actually held the asset in question during administration (during which time the asset earned taxable income).
(75) IRC Sec. 661(a).
(76) The deduction for distributions by the estate is further limited; no deduction is allowed to the extent the distribution exceeds the estate's DNI (distributable net income) in the tax year.
(77) IRC Sec. 642(c).
(78) Reg Sec. 1.663(a)-2.
(79) Furthermore, that payment of gross income for charitable purposes must be made under the terms of the decedent's governing instrument, typically a will. See IRC Sec. 642(c); Riggs National Bank of Washington, D.C., tr v. U.S., (1965, Ct Cl) 173 Ct Cl 479, 352 F2d 812, 16 AFTR 2d 5881. Absent a will (and specific provision in that will requiring the payment to a qualified charity), the IRS will disallow the estate's charitable deduction–even if the beneficiaries unanimously agree to the gift. See IRS Pub No. 559. This "specific provision in the will for charity" requirement could be met if state law gives the charity a right to the income. For instance, if a residuary charitable beneficiary had a right under state law to income earned by the estate during the administration period, the payment would be treated as if made under the decedent's will. See PLR 8318043. Conversely, if the personal representative has the discretion to satisfy a charitable bequest under the will from estate income under local law and neither the will nor state law requires the payment made to the charity be from gross income, the IRS will claim that the specific provision rule was not met. See PLR 8031024. Planners should therefore be certain that where the charity is a residuary beneficiary, the will specifically provides for payment to charity of gross income earned during the period of administration.
(80) IRC Sec. 661(a)(2).
(81) Reg Sec. 1.663(a)-2. Frank Mott, exr v. U.S., (1972, Ct Cl) 199 Ct Cl 127, 462 F2d 512, 30 AFTR 2d 72-5193, 72-2 USTC, cert den (1973, S Ct) 409 US 1108, 34 L Ed 2d 688. See also



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com

# $4,000,000 Private Placement of Equity Securities



RiskAssessment™
Memphis, Tennessee

has successfully completed the private placement of the equity securities

The Undersigned Acted as Placement Agent in Arranging the Equity Offering:

**Asset Services Investment Securities, Inc.**
Placement Agent
530 Oak Court Drive, Suite 155
Memphis, TN 38117
(901) 684-1274

April 1993


O'Connor, Est, (1977) 69 TC 165; United States Trust Co v. IRS, (1986, CA5) 803 F2d 1363, 58 AFTR 2d 86-6152, 86-2 USTC 86-2 USTC, revg & remg (1985, DC MS) 617 F Supp 575, 56 AFTR 2d 85-6313, 85-2 USTC, 85-2 USTC.

(82) IRC Sec. 401(a)(11) and 417(c)(1). These rules do not apply to the excess of death proceeds over the present value of nonforfeitable benefits existing immediately before the death of a participant in a defined benefit pension plan. Reg. Sec. 1.401(a)-20.

(83) Reg. Sec. 1.401(a)-20, Q&A 28.

(84) Reg. Sec. 1.401(a)-20, Q&A 31(a). There is, however, a "general consent" which, if signed by the spouse, would allow the plan participant to change the beneficiary designation or form of payment without further consent.

(85) Code Section 691(a)(2) and Reg. Sec. 1.661(a)-2(f)(1). See Price, Contemporary Estate Planning (1992).

(86) See Monroe, Estate Planning for the Agent, Million Dollar Round Table. A lifetime gift of the right to renewals, even to a qualified charity, will not enable the donor agent to avoid income taxes; as each commission is paid to the charity, it will be income reportable by the agent who made the gift. See Helvering v. Eubank, 311 U.S. 122, 1940. A lifetime gift of renewals is therefore not advisable.

(87) See Plotnick and Leimberg, How to Settle An Estate (1992).

(88) Note that the federal estate tax charitable deduction for the charity's remainder interest is $1,000,000 contributed at death less the present value of the annuity retained for the income beneficiary, $673,974. This amount, unless payable in marital deduction qualifying manner to the client's surviving spouse, is subject to federal estate tax.



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission. www.manaraa.com