1948 Tax Ct. Memo LEXIS 158

A deduction for income tax purposes for amounts permanently set aside for charity will not be allowed if there is a more than remote possibility that the corpus of the trust will be invaded to pay the life beneficiary.

Summary

The Estate of Brooks sought to deduct capital gains as amounts permanently set aside for Rutgers College, a qualified charity, under the will's testamentary trust. The Tax Court denied the deduction because the will directed the trustees to invade the corpus if the trust's ordinary income was insufficient to provide the testator's wife with monthly payments of at least $1,500. The court reasoned that due to the life beneficiary's life expectancy, the volatility of the stock-heavy trust corpus, and the narrow margin between the income and the required minimum payments, the possibility of invasion was not so remote as to reliably predict that it would not occur, therefore the amount was not considered permanently set aside for charity.

Facts

The decedent's will created a testamentary trust. The entire income was to be paid to his wife for life, and the remainder to Rutgers College.
Capital gains were to be added to the trust's principal.
The trustees were directed to draw upon the principal if necessary to ensure the wife received monthly payments of at least $1,500.
At the time of death, the life beneficiary had a life expectancy of 13 years and 172 days.
The trust corpus consisted largely of common stocks.
Available income had averaged only 1.66 times the required minimum payments.

Procedural History

The Estate of Brooks sought a deduction on its income tax return for capital gains that were allegedly permanently set aside for charitable purposes. The Commissioner disallowed the deduction. The Estate then petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether the net capital gain realized by the executors of the decedent's estate is deductible under Section 162(a) of the Internal Revenue Code as an amount permanently set aside for charitable purposes, considering the possibility of corpus invasion to meet the life beneficiary's minimum income requirements.

Holding

No, because the possibility of invasion of the corpus was not so remote that one could reliably predict that invasion would not occur.

Court’s Reasoning

The court acknowledged that the mere existence of a power to invade the corpus does not automatically disqualify a charitable deduction. The standard is whether the value of the gift to charity is presently susceptible of reasonably definite ascertainment. If the possibility of invasion is so remote as to be negligible, the deduction is allowable. The court emphasized that the burden is on the petitioner to establish facts justifying the conclusion that the possibility of invasion is remote.

The court considered the age and expectancy of the life beneficiary, the value of the corpus, the available income, the nature of the corpus, and the trustee’s experience. It noted that the income was dependent on dividends, which fluctuate with economic conditions, and that the available income had only a small margin over the required minimum payments. The court also took judicial notice that the period of proof was during wartime, when economic conditions were more favorable than usual. It found the narrow margin of safety of available income over the minimum requirements, and the source of the income to be factors that did not lend themselves to reliable prediction, and did not justify the conclusion that there exists no reasonable uncertainty an invasion of the corpus will not occur during the existence of the trust.

Practical Implications

This case highlights the importance of carefully drafting testamentary trusts that include charitable remainders. To ensure deductibility of amounts set aside for charity, the possibility of corpus invasion must be demonstrably remote. Factors such as the life beneficiary’s age and health, the historical income of the trust, the nature of the trust assets, and the trustee’s investment strategy should be considered. Attorneys should advise clients to structure trusts in a way that minimizes the risk of invasion, such as by providing for a sufficient income stream or establishing a reserve fund. Later cases have cited this case for the proposition that the possibility of invasion of a trust corpus must be so remote as to be negligible in order to obtain a charitable deduction.