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Controversy spoils charitable deduction

A recent Tax Court decision shows how estates of well under $1 million can run into significant tax trouble.

Eileen Belmont's 1994 will left all of her property to her mother, Wilma. It further provided that should Wilma die first, Eileen's brother David was to receive $50,000, and the balance of the estate would pass to the Columbus Jewish Foundation. Wilma died in 2001, and Eileen died in 2007, so the contingent disposition applied.

Eileen's estate consisted of $243,463 in the State Teacher's Retirement Pension Fund, a home in Ohio that was sold by the executor for $217,900, and a condo in Santa Monica, California. The condo had been owned by Wilma, and brother David had moved in with Wilma to help care for her. Both of them returned to Ohio about a year before Wilma died. David moved back into the condo in 2006, living there rent free for about nine months until Eileen died.

David wanted to exchange his $50,000 bequest for a life tenancy in the condo. The Foundation countered with a "$10,000 stipend" if David would vacate the premises immediately.

He did not vacate the premises and, instead, filed a creditor's claim in Los Angeles County Probate Court, alleging breach of an oral contract between himself, Eileen and Wilma. He claimed that he had been promised lifetime use of the condo in exchange for his services in caring for Wilma.

In its fiduciary income tax filing of July 17, 2008, the estate claimed a charitable deduction of $219,850 for the amounts passing to the Foundation. However, that amount had not been paid, nor had it been segregated from other funds used to pay administrative expenses.

The probate court accepted David's claim to the condo in October 2011. The estate lost its appeal of the verdict in February 2013. David was awarded use of the condo for the rest of his life.

The IRS denied the estate's charitable deduction because nothing had been permanently set aside for the Foundation as of the date of the tax filing. The estate argued in the Tax Court that as of that date, the chance that it would not have sufficient funds to pay the charitable bequest was so remote as to be negligible. The Court disagreed, noting that the estate was on notice of the pending litigation. Because there was a real possibility that the estate would be depleted before payment to the charity was made, no charitable deduction was permitted. That will increase the income tax due, and further reduce the amount going to the charity.

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