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The Federal Transfer Tax Consequences of Joint and Mutual Wills

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THE FEDERAL TRANSFER TAX CONSEQUENCES OF JOINT AND MUTUAL WILLS

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Editors' Synopsis: Mutual wills are an estate planner's nightmare. They create questions of intent and interpretation under state law and pose disasterous federal wealth transfer tax consequences. This article discusses the use of mutual wills, provides an exegesis of the estate and gift tax consequences that flow from their use, and suggests alternatives to better accomplish the testators' intended goals. Although the law is not especially clear on the subject, it uniformly is not favorable. Lawyers who aren't persuaded that these are poor documents to use will come away convinced. Those who must deal with such documents drafted by others will find the article useful in trying to determine the consequences thereof.

The mention of joint and mutual wills to most experienced trusts and estates attorneys will likely evoke a sardonic smile and the comment that the subject can be covered in one word—"Don't!"[1] For this reason, the initial assumption is that these documents are homemade, prepared by individuals who know little of the intricacies of the law of contracts, decedents' estates, or wealth transfer taxation. Yet a number of them include rather sophisticated dispository schemes, indicating that they were drafted by an attorney who probably had definite estate planning goals in mind.[2] Nevertheless, why an attorney would employ a joint and mutual will to fulfill the clients' goals is unclear. There are no estate planning goals that can be implemented better using a joint and mutual will than by preparing separate documents for each testator.[3] Indeed, testators frequently fail to obtain their desired wealth transfer tax results by bequeathing property under a joint and mutual will, and clearly would have been better served had they been advised to use some other implementing document.

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[1]For more serious admonitions to the same effect, see, for example, B. Sparks, Contracts to Make Wills 30 (1956) (hereafter cited as Sparks); Comment, The Contractual Will: Invitation to Litigation and Excess Taxation, 48 Tex. L. Rev. 909, 924 (1970). Professor William Herbert Page is reported to have told his classes: "Never draft a joint will for your clients." Kroncke, Joint and Mutual Wills Revisited, 43 Wis. B. Bull. 28, 32 (Oct. 1970).

[2]See, for example, Estate of Seigel v. Commissioner, 67 T.C. 662 (1977).

[3]Accord, Sparks at 30 (cited in note 1). Even clients who wish to bind each other to leave their own separate property to certain individuals after their deaths can achieve this result with greater certainty using an irrevocable trust.

Nevertheless, a large number of joint and mutual wills continue to be executed and they, in turn, generate a large number of tax cases, as taxpayers and the Commissioner seek to determine the federal wealth transfer tax consequences of executing, and bequeathing property under, a joint and mutual will.[4]

A basic tenet of the federal law of wealth transfer taxation is that the rights created under state law by the document of transfer must first be determined and then the tax law must be applied to the rights thus determined.[5] Therefore, one of the basic tasks of a federal court sitting to determine the transfer tax liability generated under a joint and mutual will is to determine the nature of the interests created by the will under applicable state law. The Supreme Court's decision in *Commissioner v. Estate of Bosch*[6] requires that a federal court make an independent determination of all relevant state law questions unless the state supreme court has interpreted the particular will in question.

Federal courts have carried out the task of construing joint and mutual wills with varying degrees of success. Sometimes a federal court simply fails to ask the right questions under state law, or answers incompletely the questions it poses. Sometimes the federal court construes the state law correctly but the state law does not comport with the intent of the parties and the effectuation of their actual intent might have provided different transfer tax consequences. Occasionally, having asked and answered fully the appropriate state law questions, the federal court simply misapplies the federal tax law.

This article first summarizes briefly several of the definitional problems that are most frequently encountered in determining the general state law rules governing joint and mutual wills. It then summarizes the development of the law of federal estate and gift taxation of transfers pursuant to such wills and related contractual dispositions of property. Finally, it makes suggestions for a more rational system of taxation of such transfers.

PROPERTY LAW OF JOINT AND MUTUAL WILLS

It is helpful first to define three terms that often are used interchangeably in tax cases dealing with joint and mutual wills because they actually mean quite different things in property law.[7] A "joint" will is a single testamentary document signed by more than one person. It has no special status; either party may unilaterally revoke or change the terms governing his or her estate.

A reciprocal will or wills may be one document or two. Reciprocal wills are

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[4]In doing the preliminary research for this article, the author found more than 40 cases and Internal Revenue Service rulings dealing with the estate and gift tax consequences of joint and mutual wills.

[5]See, for example, S. Surrey, W. Warren, and H. Gutman, Federal Wealth Transfer Taxation 71 (successor ed. 1987).

[6]387 U.S. 456 (1967).

[7]For general discussions of the definitions of these various arrangements, see United States v. Ford, 377 F.2d 93 (8th Cir. 1967); Sparks at 26–31 (cited in note 1).

wills that make "mirror-image" bequests. Like joint wills, they have no special status and may be changed by either testator unilaterally.

A mutual will, on the other hand, is both a will and a contract. As a contract, it imposes obligations upon the parties, the violation of which may entitle the other party, or a third party, to any or all of the usual remedies for breach of contract. Commonly, one contractual obligation arising from a mutual will is that each party make certain dispositions of his or her property at death. These dispositions ordinarily are made in wills that are part of the same document as the contract.

The state property law consequences of executing joint or reciprocal wills are no different from those of any individually executed will. Therefore, the critical inquiry is whether the testators intended to execute mutual wills. That is, did they intend to bind themselves contractually. Unfortunately, testators and the attorneys who advise them frequently use the terms "joint," "mutual," and "reciprocal" interchangeably, calling a document a joint will when they mean it to be mutual, calling it "joint and mutual" when they merely mean it to be joint, and calling two documents mutual when they are merely reciprocal.

For purposes of simplicity and clarity, this article refers to any testamentary document that is executed by more than one testator as a "joint will." This permits us to separate consideration of whether each joint will is mutual (that is, contractual) and, if so, what the terms of the contract are, from consideration of what transfer tax consequences emanate from gratuitous transfers made in accordance with the contract. If a will is merely joint and not mutual, then it is treated for tax purposes as the individual will of two separate testators. The transfer tax consequences of bequests under a joint will are the same as the transfer tax consequences of bequests under two separate wills. Similarly, if the testators of reciprocal wills did not intend to bind themselves contractually by virtue of the execution of the two wills, the transfer tax consequences of the reciprocal bequests are the same as those of similar bequests under wills that have no reciprocal counterpart.

The property and contract law consequences of the execution of true contractual wills are fairly complex.[8] This is due in part to the complexity of the property transfers contemplated by the parties and in part to the failure of courts to separate the contract issues and the probate issues raised by the cases before them.[9] Furthermore, as is true of litigation involving wills generally, the construction of any given clause of the document and, indeed, the whole question of whether the document is contractually binding at all is governed in large part by a determination of the intent of the individuals who executed the document.

Inquiries into intent often have been frustrated by the inaccurate use of terms (as described above) and by a presumption in some jurisdictions that all joint wills are mutual.[10] Such a presumption encourages litigation by disappointed

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[8]See generally Sparks (cited in note 1.)

[9]For an excellent discussion of the confusion this failure has caused and suggestions for unravelling it, see id. at 110–111 and 187–200.

[10]Unif. Prob. Code § 2–701 comment (1983) (hereafter sections of the 1983 revision of the Uniform Probate Code are referred to as U.P.C. §).

legatees if one of the joint testators executes a subsequent will, and is unlikely to reflect the intent of most joint testators. To reduce such lawsuits, the drafters of the Uniform Probate Code (UPC) proposed section 2-701, which considerably limits the situations in which a contract to bequeath can be proven and explicitly eliminates the presumption that the execution of a joint will or of reciprocal wills constitutes a contract not to revoke. To date, 24 states have enacted UPC section 2-701 and two other states have enacted similar statutes.[11]

Federal courts must apply state law rules governing the quantum of evidence that is necessary to support a finding that parties intended to contract for a certain disposition of their property and did not simply execute two wills in one document. In addition, federal courts are bound by state law on what constitutes a valid contract, such as questions of offer, acceptance, consideration, and so forth. Thus, before a federal court can even begin to deal with the federal transfer tax issues of a particular will, it must grapple with a number of state law rules that are difficult to apply and that may vary from state to state, and then must engage in the imprecise task of determining the intent of individuals who often are deceased and who may not have formulated a very definite intent when they executed the document in question.

Because the primary purpose of this article is to examine the transfer tax consequences of mutual wills, it is assumed that each court's determination of the existence or nonexistence of a contractual will is correct.

GIFT TAX CONSEQUENCES

The difficulty that plagues both state and federal courts in determining the transfer tax liability generated by a mutual will stems in part from the inherent ambiguity of the document itself. Although it is a contract that creates certain legal obligations immediately upon execution, it also is a will. By definition, a will creates no legal rights until the testator dies. The parties to a contractual will thus are thinking simultaneously about two different types of legal relationships and in two discrete time frames. Although they may wish to bind each other presently, they also wish to make provision for dispositions that they do not intend to take effect until their deaths. To some extent, there is an inherent conflict in these two intentions. If, in addition, the parties fail to state explicitly what portions of the document are and are not immediately binding, the conflict, and the ambiguity, is exacerbated.

If the testators intended to bind each other contractually by executing mutual

[11]As of January 1, 1990, the following states had either adopted the entire Uniform Probate Code or selected sections, including section 2–701: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Hawaii, Idaho, Kentucky, Maine, Michigan, Minnesota, Missouri, Montana, Nebraska, New Jersey, New Mexico, North Dakota, Oregon, Tennessee, Texas, Utah and Wisconsin. New York law provides that a contract to make or not to revoke a joint will only can be established by an express statement in the instrument that it constitutes a contract between the testators. N.Y. Est. Powers & Trusts Law § 13–2.1 (Supp. 1989). Georgia has similar legislation dealing with mutual wills. Ga. Code Ann. § 53–2–51 (1988). Apparently, Louisiana does not recognize joint and mutual wills at all. La. Stat. Ann. Civ. Code Art. 1572 (1987).

wills, then the dispositions made in those wills may create enforceable rights in the parties to the wills and in third parties. Therefore, unlike ordinary wills, which are ambulatory until the death of the testator, a mutual will conceptually can effect a transfer, when it is executed or upon the death of the first testator to die, if the rights of the survivor and other beneficiaries become fixed at those times. Such a transfer could be a taxable gift made by one or both of the testators.

Historically, there has been much debate and some confusion among commentators and the courts over whether a mutual will accurately may be called "irrevocable."[12] Undoubtedly, it is useful to the development of the bodies of law governing wills and contracts to deal separately with the rights and obligations created by each type of document. However, the distinction is less useful in the law of wealth transfer taxation. Although a federal court must determine the rights and obligations of the testators and their beneficiaries under state law, it is not bound by the labels that state courts place on either those rights or the documents that create them.[13] The Internal Revenue Code (Code) imposes a tax on "the transfer of property by gift, . . . ;"[14] however, it was established early in the history of the gift tax that only transfers that completely divest the transferor of control over the property transferred are taxable transfers.[15] Therefore, a federal court should not be concerned with whether a will is called "irrevocable" under state law but, rather, with whether the transaction results in a sufficient shift of property interests under state law that the testators can be held to have made a "completed gift," the label that the Treasury Regulations (Regulations) place upon a gratuitous transfer of an interest in property to another under terms that preclude the transferor from controlling that interest thereafter.[16] It is well settled in the law of wealth transfer taxation that the gift is complete and, therefore, taxable when a contract to make a gift becomes executory.[17] Therefore, for purposes of determining gift tax liability, it should make no difference whether a will is regarded as irrevocable by virtue of the contract, or as ambulatory, if the rights of the other party to the contract, and of third parties, emanate from the contract rather than from the will.

This section explores situations in which gift tax liability could occur, and analyzes the opinions of the courts and the rulings of the Internal Revenue Service (Service) that have considered the question.

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[12]See Sparks at 11-21 (cited in note 1).

[13]Morgan v. Commissioner, 309 U.S. 78 (1940). See also Commissioner v. Copley's Estate, 194 F.2d 364 (7th Cir. 1952); Commissioner v. Rosser, 64 F.2d 631 (3d Cir. 1933).

[14]Section 2501(a) of the Internal Revenue Code of 1986, codified at 26 U.S.C. § 2501(a) (1986) as section 2501(a) of the Internal Revenue Code of 1954, which was redesignated the Internal Revenue Code of 1986 by P.L. 99-514, § 2(a), 100 Stat. 2095. Hereafter, sections of the Code in force on January 1, 1989 will be cited in text as "section" and in footnotes as "I.R.C. ."

[15]Burnet v. Guggenheim, 288 U.S. 280 (1933).

[16]Treas. Reg. § 25.2511-2(b) through -2(d) (1983). Hereafter, Regulations in force on January 1, 1989 will be cited without a date. Regulations no longer in force as of that date will be cited as "Former Treas. Reg." with a date.

[17]Commissioner v. Copley's Estate, 194 F.2d 364 (7th Cir. 1952); Rev. Rul. 79-384, 1979-2 C.B. 344.

Upon Execution of the Mutual Will

If execution of a mutual will immediately binds the testators not to revoke their dispositions, then they might be deemed to have made taxable gifts at the time of execution.

The question whether a mutual will makes a present transfer under state law seems to arise most frequently in the context of nonprobate assets, particularly assets held by the parties to a mutual will as joint tenants with right of survivorship or as tenants by the entirety. Interestingly, and perhaps somewhat surprisingly, a number of state courts have held that joint title is severed by executing a mutual will that disposes of jointly held assets in a way that is inconsistent with the survivorship rights of the joint tenants.[18] Thereafter, the joint tenants own the property as tenants in common. On the other hand, if the terms of a joint will are consistent with the rights of joint tenants generally, state court decisions generally hold that the will does not sever the joint tenancy.[19] Thus, for example, if there is nothing in a will that alters the survivor's status as outright owner of the jointly held asset, the joint tenancy is not severed upon execution of the will and the interest of the first tenant to die passes to the surviving tenant under the terms of the deed creating the joint tenancy, rather than under the will.

To date, no court has confronted directly the question of gift tax liability when a mutual will is executed.[20] However, in connection with a determination of a surviving testator's gift tax liability at the death of the first testator to die, the Tax Court has reasoned that severance of a tenancy by the entirety occurs upon execution of a mutual will. *Estate of Stewart v. Commissioner*[21] involved a mutual will executed by spouses, under which one-half of the property owned by the testators as tenants by the entirety was bequeathed to the couple's children upon the death of the first spouse. The Tax Court held that the surviving spouse made no gift to the children in the year the deceased spouse died. The court reasoned that half of the property passed directly to the children from the deceased spouse because, under the applicable state law (Indiana), execution of the mutual will severed the tenancy by the entirety.[22]

Although the Tax Court noted that conversion of a tenancy by the entirety into a tenancy in common could be a taxable gift, it declined to rule on the gift tax consequences of the conversion in *Stewart* because the issue was not raised by the Commissioner.[23] Thus, the court left open the question whether either spouse

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[18]See, for example, In re Estate of Waks, 386 So.2d 307 (FL App. 1980); Lancellotti v. Lancellotti, 377 A.2d 1315 (RI 1977); In re Estate of Rooney, 317 P.2d 416 (KS 1957); McDonald v. Morley, 101 P.2d 690 (CA 1940).

[19]See, for example, In re Estate of Laue, 589 P.2d 558 (KS 1979); First United Presbyterian Church v. Christenson, 356 N.E.2d 532 (IL 1976).

[20]In Private Letter Ruling 6402041580A (February 4, 1964), the Service noted that such a severance could occur, but did not deal with the resulting tax consequences because it held that no severance had occurred under the facts before it.

[21]79 T.C. 1046 (1982), acq., 1984–1 C.B. 2.

[22]Id. at 1053.

[23]Id. at 1054 n.14.

made a gift to the other upon execution of the will.[24] If the Tax Court, and state courts, mean literally that a severance occurs upon *execution* of a mutual will, then such a gift could have occurred. Under current law, any such gift made by one spouse to the other qualifies for the unlimited marital deduction.[25] Therefore, even if a gift occurs upon severance of the joint tenancy between spouses, there is no gift tax due. However, if the joint tenants are not spouses, such a gift may be taxable. Gift tax liability in such a case depends upon whether either tenant paid more than one half the cost of the asset and whether the joint tenancy was unilaterally severable by either tenant from its inception.[26]

Stewart is the only gift tax case that discusses the question of severance of a joint tenancy at the time of execution of a mutual will. However, trial court decisions in three earlier cases dealing with the estate tax ramifications of testamentary contracts between spouses implied that testators make completed gifts of interests in their jointly held property upon execution of the contracts.[27] All three

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[24]Although the Tax Court stated correctly that, under Indiana law, execution of a mutual will that is inconsistent with a tenancy by the entirety severs the tenancy, the language in the Stewarts' will was not inconsistent with continuation of the tenancy. Indeed, the clause in question more likely evidenced an intent that the tenancy by the entirety remain unchanged until the death of one of the spouses. Thus, no gift may have been intended upon execution.

[25]I.R.C. § 2523(a). When the Stewarts' will was executed, the marital deduction was limited to half the value of the gift. Former I.R.C. § 2523 (1981). Therefore, if one of the Stewarts paid more than half of the cost of the jointly held property, a taxable gift could have occurred upon severance of the Stewarts' joint tenancy.

[26]Treas. Reg. § 25.2511–1(h)(5). If each tenant pays half of the cost, neither tenant makes a gift to the other upon creation of the tenancy or upon severance. However, if one tenant paid more than half of the cost, that tenant makes a gift to the other upon creation of the tenancy if the tenancy is severable by either tenant unilaterally. If both tenants must consent to severance, the gift is made upon severance in equal shares. In either case, the value of the gift is determined under the "consideration furnished" test. The tenant who paid more than half the cost of the property makes a gift to the other tenant of the portion in excess of what is received on severance. Thus, if one tenant paid one-third of the cost and the other paid two-thirds, the tenant who paid two-thirds makes a gift to the other tenant of one-sixth (two-thirds minus one-half) of the fair market value of the asset if, on severance, they are equal owners. The annual exclusion applies to that gift.

[27]Wilcoxen v. United States, 310 F. Supp. 1006 (D. KS 1969); Lindsey v. United States, 167 F. Supp. 136 (D. MD 1958); Estate of Peterson v. Commissioner, 23 T.C. 1020, rev'd per curiam, 229 F.2d 741 (8th Cir. 1955). See also Priv. Ltr. Rul. 6402041580A (February 4, 1964) (property owned as joint tenants with right of survivorship by spouses who executed mutual will purporting to place the property in trust at the first death held fully includible in estate of first to die under consideration furnished test (that is, no severance at execution of will) but denied marital deduction because will gave survivor a nondeductible terminable interest). *Wilcoxen* and *Lindsey* involved two separate documents: an individual will executed by the husband and a separate "consent" to the terms of the will signed shortly thereafter by the wife while her husband was still alive. The two courts distinguished the cases before them from mutual will cases on this ground. This distinction is ill-conceived for two reasons: First, a mutual will is really two documents in one, a will and a contract. The federal wealth transfer tax consequences should not differ because the parties choose to execute two separate documents, if the resulting shift in property rights under state law is the same as would occur under one document. Second, legal title to the property in question was in fact jointly held of record both before

cases dealt with whether the jointly held property qualified for the federal estate tax marital deduction[28] in the estate of the deceased husband, the wife having survived. All three decisions found the jointly held property fully includible in the deceased husband's estate.[29] However, all three denied the marital deduction to the husband's estate because the surviving wife's interest in the jointly held property amounted to no more than a life estate coupled with a nongeneral power to consume, which is a nondeductible terminable interest.[30]

Nonprobate property that is includible in the gross estate of a deceased spouse and that passes outright to a surviving spouse by virtue of survivorship provisions of a deed or other document of title ordinarily qualifies for the federal estate tax marital deduction.[31] Implicit in these courts' holdings, therefore, is a finding that the property did not pass to the wife outright at the husband's death but, rather, was subject to the provisions of the deceased husband's will. This finding, in turn, can be accurate only if the wife transferred her interest in the property to her husband prior to her husband's death. Such a transfer can have occurred only at execution of the testamentary contract. Indeed, one opinion states explicitly that, by virtue of the spouses' contract, the property is to be treated for estate tax purposes as though the husband owned it alone at his death.[32]

To date, no court has found the transfer to third parties of an interest in individually owned assets to be complete for gift tax purposes when a mutual will is executed. Although the predeceased spouse's transfer tax liability was not at issue in *Stewart*, the opinion implies that the transfer of a one-half interest in the

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and after execution of the consent. Each wife already owned an interest in the jointly held property when she executed the consent. If the consent made any present transfer at all, it transferred a remainder interest in the property to the ultimate beneficiaries, rather than transferring a present interest to the husband.

[28]Qualification for the federal estate tax marital deduction of property passing under a mutual will is discussed at text accompanying notes 125–168.

[29]It is not possible to infer from these holdings that the courts in the three cases under discussion found that the property in question was owned by the husband alone on the date of his death. Prior to 1976, all property held by spouses as joint tenants with right of survivorship or as tenants by the entireties was subject to the general consideration furnished test of section 2040(a). Therefore, if the husband provided all consideration paid for the jointly held assets, the courts would have had to hold the entire value of the jointly held assets includible in the husband's estate. Such a holding would not, however, bear on whether the property passed to the surviving wife under the husband's will or under the deed creating the joint tenancy because that question is determined under state property law.

[30]I.R.C. § 2056(b).

[31]Id. § 2056(c)(5).

[32]Lindsey v. United States, 167 F. Supp. 136, 138 (D. MD 1958). The only issue before the court in *Lindsey* was whether the jointly held property qualified for the estate tax marital deduction. The court did not elaborate on the time, extent, or gift tax consequences of the wife's gift to her husband of her interest in the jointly held property. However, the court found as a matter of property law that the wife received bare legal title to the property by surviving her husband, subject to a constructive trust to convey the property to her husband's testamentary trustees. This analysis is consistent with the fact that the property was owned jointly of record until the husband died. However, this property law analysis should not affect a wealth transfer tax finding that any gift made by the wife to her husband or to the ultimate beneficiaries occurred when the contract became binding upon her.

subject property to the children was not complete for transfer tax purposes until the death of the first spouse to die.[33] This aspect of the decision clearly is correct and is equally applicable to jointly held and individually held assets. In general, a mutual will is revocable by either testator with the consent of the other.[34] For gift tax purposes, therefore, transfers of jointly held assets under mutual wills to third parties essentially are the same as joint transfers to a joint settlor revocable trust,[35] and transfers of individually held assets essentially are the same as transfers that can be revoked with the consent of a party who does not possess a substantial adverse interest in the subject property,[36] both of which are treated as incomplete transfers.

Testators are unlikely to intend to sever a joint tenancy at the execution of a mutual will or other testamentary contract for several reasons. First, severance by partition can be achieved quite easily today in most jurisdictions using a simple deed. Using a will for that purpose is not the approach a sensible client would adopt. Second, if the testators are a married couple, their choice of a mutual will suggests an intent to deal with the entire family estate as a single whole. During their joint lives, this goal is accomplished most easily by leaving the joint tenancy intact. Finally, because testators of mutual wills ordinarily contemplate that each will die leaving a will containing particular provisions,[37] neither intends to make a transfer until the first death. Consequently, unless the mutual will explicitly states otherwise, severance of a joint tenancy should not be held to occur before the death of the first testator to die.

At the Death of the First Testator to Die

This section focuses on the extent to which mutual wills might have gift tax consequences when one of the testators dies survived by the other testator.

Has the Survivor Made a Gift?

If the dispositions under a mutual will become irrevocable at the death of the first testator to die, then the surviving testator makes a gift of a future interest in the survivor's property at the same time to those who are the designated beneficiaries after the survivor's death. Although at least one major commentator agrees,[38] he also predicts that gift tax liability will rarely accrue at the death of the first testator to die because the gift will not be "complete."[39] The Regulations state that a transfer may be complete even though it remains subject to the donor's power to alter the shares that each previously-named beneficiary will receive, or the time at which a beneficiary will receive a share, but a transfer under which the prop-

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[33] 79 T.C. at 1047–1048, and 1050.

[34] Sparks at 195–196 (cited in Note 1); 1 W. Page, Wills 441–442 (rev. ed. 1960 & Supp. 1987).

[35] See, for example, Black v. Commissioner, 47 T.C.M. (CCH) 1318 (1984).

[36] Treas. Reg. § 25.2511–2(e); Latta v. Commissioner, 212 F.2d 164 (3d Cir. 1954); Camp v. Commissioner, 195 F.2d 999 (1st Cir. 1952).

[37] Sparks at 30 (cited in note 1).

[38] 1 A. Casner, Estate Planning 232 (5th ed. 1984 & Supp. 1986).

[39] See text accompanying notes 15–17.

erty remains subject to the donor's unlimited power of invasion for the donor's benefit is incomplete.[40] Therefore, in most cases, any transfer of property disposed of under a mutual will should not be subject to gift tax after the death of the first testator to die because the surviving testator will have a retained power to consume the property.

The debate concerning gift tax consequences of the execution of a mutual will is of relatively recent origin.[41] To date, only two decisions have found that the surviving testator made a gift at the death of the first testator to die,[42] although one early gift tax case on a related issue implied a similar result.[43] All other decisions and rulings have favored the taxpayer, either because they hold that no contract existed between the testators[44] or because, although they find a contract existed,

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[40]Treas. Reg. 25.2511-2(c).

[41]The first Private Letter Ruling dealing with the question of gift tax liability in this context was Private Letter Ruling 7810001 (August 11, 1977), in which the Service determined that the surviving testator made a gift to the ultimate beneficiaries at the death of the first testator to die of the remainder interest in nonprobate property and in property he owned individually. The mutual will provided "after the decease of both of us . . . we, and each of us, do and does direct that all of the estate which we, or either of us, shall own or be entitled to at the time of our deaths, or the death of the survivor of us . . . shall go and be paid over . . . as follows . . . ."

The first private letter ruling dealing with the estate tax consequences of a mutual will appears to be Private Letter Ruling 6402041580A (February 4, 1964). This ruling and at least one other issued between 1964 and 1978 implied gift tax consequences without addressing those issues. In Private Letter Ruling 6402041580A, the taxpayer apparently argued for exclusion from the decedent's gross estate of half the property held by the testators (who were spouses) as joint tenants with the right of survivorship. The argument was that either the tenancy was severed when the testators executed the mutual will or the property was never subject to the mutual will and, therefore, qualified for the federal estate tax marital deduction as property passing outright to the surviving spouse from the first testator to die. The Service rejected both arguments and held that, because the will governed the disposition of the jointly held property but did not sever the joint tenancy at the time of execution, and because it limited the interest of the surviving testator to a life estate, the full value of the jointly held property was includible in the decedent's gross estate under the consideration furnished test of former section 2040(a). Moreover, the Service ruled that it did not qualify for the marital deduction because the interest of the surviving testator was a life estate that constituted a nondeductible terminable interest. This conclusion assumes that the interest of the surviving testator in the jointly held property was reduced from a fee simple to a life estate, either upon execution of the mutual will or at the death of the first testator to die, which is questionable under state law. If that reduction occurred, however, the surviving testator presumably made a taxable transfer of a remainder interest in the jointly held property. However, the surviving testator's gift tax liability was not at issue.

Similarly, the holding in Private Letter Ruling 7412103180D (December 10, 1974) denying the marital deduction in the estate of the first testator to die for individually owned property passing under a mutual will implied that the surviving testator may have made a gift of a remainder interest in the survivor's separate property at the death of the first testator to die because the terms of the mutual will required the survivor to bequeath the survivor's property and that acquired under the mutual will to designated beneficiaries. Again, however, the survivor's gift tax liability was not at issue.

[42]Estate of Grimes v. Commissioner, 851 F.2d 1005 (7th Cir. 1988); Pyle v. United States, 766 F.2d 1141 (7th Cir. 1985).

[43]Commissioner v. Masterson, 127 F.2d 252 (5th Cir. 1942).

[44]See, for example, Hambleton v. Commissioner, 60 T.C. 558 (1973); Brown v. Commissioner, 52 T.C. 50 (1969); Priv. Ltr. Rul. 7910004 (August 31, 1978).

they hold that the surviving testator retained an unlimited power to consume the survivor's own estate.[45]

Nevertheless, several federal court of appeals decisions on related issues have implied that a gift by the surviving testator must have occurred. The possibility that the surviving testator of a mutual will might make a completed gift at the death of the first testator to die was first implied in *Commissioner v. Masterson.*[46] In *Masterson,* the Court of Appeals for the Fifth Circuit determined a surviving wife's gift tax liability upon her release of her remaining interest in her share of property formerly owned as community property with her deceased husband. The couple had executed a joint and mutual will that disposed of all the family assets, including their community property. Mr. Masterson died, survived by his wife, who had the will admitted to probate as Mr. Masterson's will. Four years later, Mrs. Masterson released her remaining interest in her half of what had been their community property. To determine the gift tax due on that release, the court determined the value of the property rights released, because the release stated that Mrs. Masterson relinquished all of her remaining interest in her half of the community property.

The majority of the court in *Masterson* interpreted the language of the will[47] as limiting Mrs. Masterson's interest in all of the community property; therefore, it held that the gift upon her release was the value of half her life estate in the total community.[48] As the majority recognized, implicit in this holding was the finding that Mrs. Masterson made a gift of the remainder interest in her half of the community property at Mrs. Masterson's death.[49] Indeed, the precise issue upon which the members of the court disagreed was whether Mrs. Masterson made a transfer of any kind at Mr. Masterson's death. Judge Holmes argued in dissent that

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[45]See, for example, Estate of Lidbury v. Commissioner, 800 F.2d 649 (7th Cir. 1986); Priv. Ltr. Rul. 7944009 (July 10, 1979); Priv. Ltr. Rul. 7910004 (August 31, 1978)(dictum). See also *Scofield v. Bethea,* 170 F.2d 934 (5th Cir. 1948), an estate tax case dealing with includibility in the gross estate of the surviving testator of certain property bequeathed by a mutual will, in which the court found that the survivor transferred no interest in the property at the death of the first testator to die. Accord, Estate of Emerson v. Commissioner, 67 T.C. 612 (1977).

[46]127 F.2d 252 (5th Cir. 1942).

[47]The will provided in pertinent part:

> II. It is our will and desire that the survivor of us, R. B. Masterson or Anna Eliza Masterson, as the case may be, shall, with the rights and authority below given, have all the estate of every description, real, personal, or mixed, which either or both of us may own, to be used, occupied, enjoyed and expended by and during the life of said survivor, with the full management and control thereof, with the right to receive all rents and revenues, invest all moneys of the estate, pay all taxes and assessments, indebtedness and other proper and just claims and charges against said estate and joint property; but with the limitation, however, that neither of us as such survivor shall have the right or power to sell and dispose of any of said estate except for the purpose of (1) paying proper and legal charges and claims against said estate, (2) provide [sic] for the maintenance and support of the survivor of us, and (3) such sale and distribution . . . may be made . . . for the purpose of distributing said estate share and share alike among the children named in Paragraph 2, Subdivision I, hereof, ..."

Id. at 253.

[48]Id. at 256.

[49]Id. at 255. There was no gift tax in effect in 1931, when Mr. Masterson died.

the widow made a gift of her entire share of the community property at the time of the release; he reasoned that she could not have made a transfer at her husband's death because her part of the will could not take effect until she died.[50] This logic was subsequently accepted by the Court of Appeals for the Fifth Circuit in deciding two estate tax cases involving joint and mutual wills.[51]

The disagreement between the majority and the dissenter in *Masterson* demonstrates the difficulty inherent in determining the transfer tax consequences of mutual wills. Each opinion stated correctly the tax consequences of the transfers that the author of the opinion believed to have occurred at the death of Mr. Masterson and at the time of Mrs. Masterson's release. However, only the majority's statement of the transfers that took place is accurate. If the Mastersons' mutual will was both a contract and a will, then the fact that a will is ambulatory until the death of the surviving testator is correct but irrelevant to the determination of whether the surviving testator made a transfer at the death of the first testator to die. Mr. Masterson performed his obligations under the contract embodied in the mutual will by leaving as his will the testamentary provisions of the mutual will. Thereupon, Mrs. Masterson became obligated under the contract embodied in the mutual will to dispose of the remainder interest in her half of the community property in accordance with that contract. Her obligation to leave a will bequeathing the remainder interest to the named beneficiaries was fixed at Mr. Masterson's death because the contract then became executory as to her. Therefore, for gift tax purposes, Mrs. Masterson's transfer of the remainder should have been

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[50]Id. at 256.

[51]McFarland v. Campbell, 213 F.2d 855 (5th Cir. 1954) (husband's estate may claim a charitable deduction for the remainder interest in his share of community property that passed to charity pursuant to mutual will executed with wife, but not for a similar interest in the wife's share of community property; nothing belonging to wife passed to charity at husband's death); Scofield v. Bethea, 170 F.2d 934 (5th Cir. 1948) (wife's interest in her share of community property did not change at her husband's death; therefore, it was includible in her estate even though, pursuant to the terms of a mutual will she executed with her husband, all of the community property passed to a trust at her husband's death). Judge Holmes wrote the majority opinion in both of these cases.

Interestingly, the decision in *McFarland* achieved the correct result using rather strained reasoning despite the availability of a more straightforward argument. The Court could have found that the husband's estate in *McFarland* was not entitled to a charitable deduction for property that only could have been transferred to charity by the wife; the husband had no power to control disposition of the assets in question. Today, a more direct route to the correct result also would be available in a case with facts similar to those in *Scofield.* Under current law, the wife's share of the community property would be includible in her estate on the ground that she made a transfer with a retained interest at her husband's death. I.R.C. § 2036(a). However, *Scofield* was decided under section 302(c) of the Revenue Act of 1926, Pub. L. No. 69–20, § 302(c), 44 Stat. 9, 70 (1926), which the Supreme Court held inapplicable to transfers with retained life estates in May v. Heiner, 281 U.S. 238 (1930).

The Tax Court cited these cases to support its holding in a more recent case that would have been appealable to the Court of Appeals for the Fifth Circuit. Estate of Emerson v. Commissioner, 67 T.C. 612 (1977), held that the surviving husband's half of community property and one-half of his separate property were includible in his estate upon his subsequent death under Code section 2033, not section 2036, because no interest passed at his wife's death from him to the residuary beneficiaries under the spouses' joint will. However, the court in *Emerson* did not state explicitly that it found the will to be contractual.

treated as complete at her husband's death.[52] Although Mrs. Masterson's will was ambulatory until her death, her obligations under the contract were not. The fact that the beneficiaries would have had a cause of action for a breach of contract, rather than grounds to contest the probate of her will, if Mrs. Masterson had changed her will after Mr. Masterson's death, is irrelevant for gift tax purposes.

The Court of Appeals for the Seventh Circuit reached a result that is consistent with this analysis in *Olson v. Reisimer*.[53] Mrs. Olson predeceased her husband and, at her death, the couple's joint will was probated. The state court regarded the will as contractual and as granting Mr. Olson a life estate in the family assets, with a power to consume principal for his care, comfort, and maintenance.[54] The remainder of the property was to pass to the couple's son at Mr. Olson's death. The state court held that the will applied to the couple's jointly held assets.[55]

Upon Mr. Olson's death, the Court of Appeals for the Seventh Circuit held that half the value of the jointly held assets was includible in Mr. Olson's gross estate under section 2036 as property that he transferred subject to a retained life estate.[56] This result implies that Mr. Olson made a completed gift of the remainder in his half of the jointly held property at his wife's death. Given the state court's holding that the Olson's will was contractual, the analysis of the Court of Appeals is correct.

In *Pyle v. United States*,[57] the Court of Appeals for the Seventh Circuit determined the gift tax consequences of a joint will that gave each testator a fee simple interest in the property of the other at death, but made extensive and complex provisions for the disposition of their family assets after the death of the surviving testator.[58] In a construction proceeding brought shortly after the death of the first testator to die, the state court held that the will granted the surviving testator a fee simple interest in all property owned by the deceased testator at death. The court also found that the will constituted a contract between the testators and that, by executing the joint will, the surviving testator had reduced her interest in the

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[52]See note 17 and accompanying text.

[53]271 F.2d 623 (7th Cir. 1959).

[54]Id. at 625. The decision of the Columbia, Wisconsin county court is unreported. It was rendered in a proceeding begun by the remainder beneficiaries of the Olsons' will when the surviving husband attempted to lease some of the family's real estate. Id. The Olsons' will provided in pertinent part:

> Third: I, and each of us, give, devise and bequeath to the survivor of us all property, real, personal or mixed, owned jointly, as husband and wife, severally, in common, or in any capacity to have and to hold for the use, management, control and income thereof during said survivors [sic] natural life. In the event however, that the use and income thereof shall not be sufficient for the care, comfort and maintenance of such survivor, then he shall have the right to use all or such portion or part of the principal as may be necessary.

Id. at 624.

[55]Id. at 625.

[56]Id. at 627.

[57]766 F.2d 1141 (7th Cir. 1985).

[58]Id. at 1142.

property to a life estate plus a power to consume it for her "health, support, comfort, and maintenance requirements."[59]

The federal district court held that the survivor did not make a taxable gift at the time of the decedent's death because, for federal transfer tax purposes, the survivor retained an unlimited power of invasion over the property.[60] The district court reached this conclusion because the conditions of invasion stated in the state court opinion included the word "comfort," a term that precludes a finding that the power is limited by an ascertainable standard under the Regulations governing general powers of appointment.[61] The district court also noted that a similar result is implied by the Regulations dealing with the completeness of a gift.[62] Therefore, the court concluded, the survivor did not make a completed transfer of the remainder interest in the testators' assets at the decedent's death.

The Court of Appeals for the Seventh Circuit reversed, holding that the survivor made a gift to the remainder beneficiaries at the decedent's death of the present value of the remainder in the trust following the survivor's life estate, minus the value of the survivor's power of invasion.[63] The court reasoned that "ascertainable," when used to determine whether a gift is complete, means simply that the amount of property that the survivor may consume is capable of valuation under state law. The court found that the survivor's interest was capable of valuation under state law,[64] and remanded the case to the district court for valuation of the gift.

The court of appeals opinion in *Pyle* represents the first time that a federal court has attempted to describe the method of valuing a gift of such a remainder interest under a mutual will. Furthermore, the method the court of appeals described appears to be correct for federal transfer tax purposes, provided that the testators of the mutual will intended to create a limited power of invasion over an ascertainable amount, as found by the court of appeals. Unfortunately, the district court finding, that the survivor made only an incomplete transfer at the decedent's death because the power of invasion was unlimited, seems more likely to reflect the intent of the testators. The district court applied the wrong gift tax provision in arriving at its decision, however. This confusion stems from the unsatisfactory manner in which the federal transfer tax law deals with powers of inva-

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[59]The will apparently did not contain any reference to a contract, but the state court construed the will as embodying a contract between the testators, and the Court of Appeals for the Seventh Circuit apparently accepted that ruling. Id. at 1142– 1143. The opinion of the state court is unreported.

[60]Pyle v. United States, 581 F. Supp. 252, 253 (C.D. IL 1984).

[61]Treas. Reg. § 20.2041–1(c)(2) (estate tax) and 25.2514–1(c)(2) (gift tax). Code sections 2041 and 2514 govern the extent to which a general powerholder makes a taxable transfer of property subject to the power by exercising the power, releasing it, or permitting it to lapse. The statutes exclude from the definition of general power of appointment those powers that are "limited by an ascertainable standard relating to the health, education, support, or maintenance" of the powerholder. I.R.C. § 2041(b)(1)(A) and 2514(c)(1).

[62]Treas. Reg. § 25.2511–1(g)(2) states that the words "pleasure, desire, or happiness" do not create an ascertainable standard.

[63]766 F.2d at 1147.

[64]Id. at 1145–1146.

sion and from the unfortunate choice of terms applied by the state court in describing the extent of the survivor's power.

Although the district court correctly summarized the Regulations concerning transfer taxation of powers of invasion under the provisions dealing with general powers of appointment,[65] the transfers in question were not governed by the sections dealing with general powers of appointment. Rather, they were governed by the provisions dealing with outright transfers of property in which the transferor retains an interest. This is because the state court construed the joint will as granting the survivor a fee simple interest in the decedent's property. In addition, the state court held that the joint will constituted a contract between the testators and, under the contract, the survivor became bound, upon receipt of the decedent's assets, to transfer them and her own assets to certain beneficiaries at her death. As the state court noted, this is the same as saying that, by permitting the decedent to die with the joint will in effect, the survivor accepted her husband's property outright and then permitted her interest in their assets to become limited to a life estate plus a power to consume. For federal gift tax purposes, then, if the survivor made a completed gift of an interest in the family assets at all, she made it at a time when she owned the property outright.

Transfers of interests in property owned outright are taxed under Code section 2511, which is the "general" gift tax section, and not under section 2514, which is the specific section that governs the taxation of transfers pursuant to a general power of appointment.[66] Although the Regulations under section 2514 state explicitly that "comfort" is not an ascertainable standard relating to "health, education, maintenance and support" and, therefore, a power to invade for comfort is a general power of appointment,[67] neither the general statute nor the Regulations under it confine the recognized "ascertainable" standards in that way. Thus, to impose gift tax liability under section 2511, the Commissioner must show simply that, by executing the mutual will and failing to alter it before the death of the first testator to die, the surviving testator irrevocably transferred a future interest in the survivor's property, which was capable of valuation at the deceased testator's death and, therefore, constituted a taxable gift.

Exactly how the word "comfort" could be given sufficient content to value the survivor's interest in *Pyle* is not clear. The court of appeals gave two justifications for its finding. First, the court noted that the other words used by the state court—"health, support and maintenance"—are recognized ascertainable standards and that the additional word does not broaden the survivor's power. There is some precedent for such a finding.[68] However, in *Pyle*, it does not seem to re-

[65]See notes 61–62.

[66]Treas. Reg. § 25.2514–1(b)(2).

[67]Id. § 25.2514–1(c)(2).

[68]See, for example, Brantingham v. United States, 631 F.2d 542 (7th Cir. 1980) ("maintenance, comfort, and happiness" creates an ascertainable standard under Massachusetts law for purposes of I.R.C. § 2041(b)(1)(A)), criticized as wrongly decided in Hess, The Federal Taxation of Nongeneral Powers of Appointment, 52 Tenn. L. Rev. 395, 412–413 (1985); Tucker v. United States, 74–2 U.S. Tax Cas. (CCH) ¶ 13,026 (S.D. CA 1974) ("reasonable care, comfort, and support" creates an ascer-

flect the intent of the testators because they did not expressly limit the survivor's power.

The second justification is that the word "comfort" alone creates an ascertainable standard under applicable state (Illinois) law. Again there is some support for this finding.[69] However, the court cited no Illinois case stating that a joint and mutual will that gives the surviving testator unlimited control over property is to be construed under Illinois law as granting the survivor a power to use the property only for comfort. Indeed, it cites at least one case that implies the contrary.[70] For tax purposes, the court of appeals was not bound by the state trial court's determination of the nature of the interests transferred under state law;[71] it was free to examine Illinois law and determine whether the Pyles' will should have been construed to give the survivor a limited power of invasion. Furthermore, even if the word "comfort" does create an ascertainable standard under applicable state law, the regulations state that it does not do so for federal gift tax purposes.[72]

If the Pyles' will had been interpreted to grant the survivor such an unlimited interest, the survivor would not have owed gift tax at the decedent's death because no interest in the family property would have passed completely beyond her control at that time. Therefore, under the method of computation outlined by the court of appeals, the value of the power of invasion would equal the value of the entire remainder interest.

Six months after its decision in *Pyle*, the Court of Appeals for the Seventh Circuit declined to find a gift in a similar case, also involving an Illinois will. In

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tainable standard under I.R.C. § 2041(b)(1)(A)). Among cases holding that a phrase including the word "comfort" creates an ascertainable standard under Code sections 2036 and 2038 (estate tax provisions dealing with transfers in which the grantor retains an interest until death), are United States v. Powell, 307 F.2d 821 (10th Cir. 1962) ("maintenance, welfare, comfort or happiness"); Jennings v. Smith, 161 F.2d 74 (6th Cir. 1947) (maintenance "in comfort and in accordance with the station in life to which he belongs"); and Estate of Bell v. Commissioner, 66 T.C. 729 (1976) (power to withhold so much as the Trustees did "not believe to be necessary for her well-being and maintenance in health and comfort").

On the other hand, standards that include the word "comfort" have been held not to create an ascertainable standard under section 2041(b)(1)(A) in Lehman v. United States, 448 F.2d 1318 (5th Cir. 1971) ("support, maintenance, comfort, and welfare"); Miller v. United States, 387 F.2d 866 (3d Cir. 1968) ("maintenance, support, or other expenses incidental to her comfort and well-being"); Doyle v. United States, 358 F. Supp. 300 (E.D. PA 1973) ("comfort, maintenance and support").

[69]See, for example, Rock Island Bank & Trust Co. v. Rhoads, 187 N.E. 139 (IL 1933), holding that the phrase "comfort and satisfaction" gave a beneficiary an unlimited power of invasion, but stating that the word "comfort" alone would have permitted her to invade only to maintain her customary station in life. But see Neilson v. Duyvejonck, 236 N.E.2d 743 (IL App. Ct. 1968), holding that a power to invade for his "comfort and support" in his own discretion gave a beneficiary unlimited power to invade, apparently because the right to exercise discretion is the right to dispose of the property in any way the beneficiary wishes, and imposes upon him only the obligation to transfer to the remainder beneficiaries what is left at his death.

[70]Neilson v. Duyevjonck, cited in note 69.

[71]Commissioner v. Estate of Bosch, 387 U.S. 456 (1967).

[72]Treas. Reg. § 25.2511–1(g)(2).

Estate of Lidbury v. Commissioner,[73] the court of appeals held that, although the will in question was clearly contractual, the surviving testator's power of invasion was unlimited because the language of the will did not create an ascertainable standard. The Lidbury will directed the surviving testator to use the testator's assets "in a careful and prudent manner, so as not to dissipate any of said property," and required that the survivor "not in any manner directly or indirectly dispose of his or her property to the end that the general plan of distribution, as provided herein, shall be altered and changed in any form whatsoever."[74] The will was not the subject of a state court construction proceeding and the court of appeals found that, although these terms indicated the existence of a contract, they did not impose a quantifiable limit upon the survivor's power to consume the property for his or her own benefit.[75]

Given the language of their wills, the testators in *Lidbury* appear more likely to have intended to limit each other's use of the family assets than the testators in *Pyle*. The only difference between the cases, when they arrived in federal court, was the presence in one of them of a state trial court decision describing the purposes for which the survivor could consume the family assets in terms some of which constituted an ascertainable standard.

Most recently, in *Estate of Grimes v. Commissioner,*[76] the Court of Appeals for the Seventh Circuit affirmed a Tax Court Memorandum decision that, under the terms of a mutual will, the surviving testator made a gift of a remainder interest in certain family assets at the death of the first testator to die. The Tax Court concluded that the will was contractual under the law of the state of the testators' domicile,[77] a finding that apparently was not disputed on appeal.[78] The Tax Court next construed the clause governing personal property as conveying the deceased testator's personal effects to the surviving testator without subjecting the survivor to any obligation concerning their ultimate disposition at his death. Therefore, the Tax Court found that the surviving testator made no gift of an interest in his personal effects or in the decedent's at the time of the decedent's death. The Tax Court then held that, because the clauses disposing of the real estate granted the survivor only a life estate in the realty and explicitly imposed upon him the obligation to preserve the property and transfer it to the testators' children at his death, the survivor made a completed gift of a remainder interest in his share of the testators' real estate at the decedent's death.[79] The Tax Court cited *Pyle* in support of its decision, and distinguished *Lidbury* on the ground that the survivor's power to dispose of the family assets was unrestricted under the Lidbury mutual will, while the survivor lost all dominion and control over the re-

[73]800 F.2d 649 (7th Cir. 1986).
[74]Id. at 651.
[75]Id. at 654.
[76]851 F.2d 1005 (7th Cir. 1988).
[77]54 T.C.M. (CCH) 1, 4 (1987).
[78]851 F.2d at 1005.
[79]54 T.C.M. at 5.

mainder interest in the realty at the death of the decedent by the terms of the Grimes mutual will.[80]

Only the taxpayer appealed. The Court of Appeals for the Seventh Circuit upheld that Tax Court's construction of the will provision dealing with real property on the grounds that it was not clearly wrong[81] but also suggested that the gift of the remainder would be complete for gift tax purposes at the death of the first testator to die even if the survivor in *Grimes* had a limited power to consume the underlying real property.[82]

In view of the language of the will in *Grimes*, the case was correctly decided. The testators appear to have intended to limit the interest of the surviving testator and to fix the interest of the couple's children at the death of the first testator to die. Therefore, the transfers to the children were complete at that time.[83]

Nonprobate Assets

A number of federal courts have considered the federal wealth transfer tax consequences of a mutual will upon the transfer at the death of the surviving testator of life insurance proceeds, jointly held property, and property held by spouses as tenants by the entirety. These nonprobate assets ordinarily do not pass

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[80]The Grimes will provided in pertinent part:

> [W]e do each jointly and mutually, in consideration of the other's making his will, of the provisions made herein in each other's behalf, and the sum of ONE DOLLAR ($1.00) in hand paid, by each of us to the other, receipt whereof is hereby acknowledged, make this our Joint and Mutual Last Will and Testament, and agree that the same shall not be changed or revoked by either of us without the written consent of the other and agree that any joint tenancy property owned by us at the date of the death of the first one of us dying shall not be capable of being disposed of by the survivor but shall pass only as hereinafter provided . . . .
>
> SECOND: We give and bequeath to each other respectively, all personal estate of every kind and character, including notes and accounts and chooses in action, and including household goods which either of us may own at the time of the one first dying, excepting our Savings & Loan accounts, our life insurance proceeds and our bonds which we will, devise and bequeath to our son, Charles E. Grimes.
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> THIRD: We hereby give, devise and bequeath to each other respectively, for and during the term of the natural life of the survivor of us, all our respective interests in the real estate hereinafter described in this THIRD clause of our Joint and Mutual Will and which real estate for convenience and brevity is referred to in this Will after the particular description thereof, by tracts numbered from one to nine inclusive.

Id. at 2.

[81]851 F. 2d at 1006.

[82]Id. at 1006–1007.

[83]Ironically, the Grimes family again found itself litigating the question of the transfer tax consequences of a joint will at the death of a son of the first Grimes decedents. In Estate of Grimes v. Commissioner, 56 T.C.M. (CCH) 890 (1988), the Tax Court decided that a bequest under the son's will failed to qualify for the marital deduction because the will, which the son executed jointly with his wife, was contractual, and therefore granted the wife a nondeductible terminable interest in her deceased husband's assets. The record includes evidence that the younger Mr. Grimes explicitly told his attorney that he did not want a contractual will because he understood from the controversy surrounding his parents' will that "a contractual will was very limiting." Id. at 891. However, the document that the attorney prepared, and Mr. and Mrs. Grimes signed, was entitled "Mutual Last Will and Testament." The Tax Court found that the will was contractual under Illinois law.

under the will of the first testator to die; instead, they pass automatically to the designated beneficiary or survivor(s) under the instrument governing the asset. Although this distinction between probate and nonprobate assets has important property law consequences, it largely is irrelevant under the federal wealth transfer tax. For example, whether life insurance proceeds are includible in a decedent's gross estate for federal estate tax purposes depends upon the nature of the decedent's interest in the policy, rather than upon whether the proceeds are subject to administration by the personal representative of the decedent's estate under applicable state law.[84]

Of the gift tax cases discussed previously, only *Estate of Stewart v. Commissioner*[85] considers the gift tax consequences of the *execution* of a mutual will upon nonprobate assets.[86] The court held, somewhat surprisingly, that the tenancy was severed when the mutual will was executed.[87]

In *Estate of Grimes v. Commissioner*[88] several savings accounts and one parcel of real estate were held by the spouses as joint tenants. The Grimes will stated that "any joint tenancy property owned by us at the date of the death of the first one dying shall not be capable of being disposed of by the survivor but shall pass only as hereinafter provided."[89] The Tax Court found that the savings accounts held by the spouses as joint tenants passed to the survivor outside of the will.[90] The Tax Court then held that the survivor made a completed gift of a remainder interest in these accounts as well as in assets he owned individually at the death

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[84]Life insurance is the subject of Code section 2042, which provides generally that the proceeds of life insurance are includible in the estate of the insured, regardless of the identity of the beneficiary, if the insured possessed any incidents of ownership with respect to the policy. If the owner is someone other than the insured, the policy is an asset that may be includible in the estate of the owner under section 2033, and will not be included in the estate of the insured unless the proceeds are payable to the estate of the insured.

Includibility of property held as joint tenants with right of survivorship or as tenants by the entirety is governed by Code section 2040. Prior to 1981, inclusion of these assets generally was governed by the consideration furnished test under section 2040(a) described in note 29. Since 1981, if the tenants are spouses, both of whom are citizens of the United States, only half of the value of the property is includible in the estate of the first spouse to die, regardless of which spouse paid for the asset. I.R.C. § 2040(b).

Both life insurance and the half of any joint asset that is included in the estate of a married person can qualify for the federal estate tax marital deduction if it passes to the decedent's surviving spouse in a manner that qualifies under section 2056. The Code has provided for an unlimited marital deduction since 1981.

[85]79 T.C. 1046 (1982), acq., 1984–1 C.B. 2, discussed at text accompanying notes 21–26.

[86]Estate of Lidbury v. Commissioner, 800 F.2d 649 (7th Cir. 1986), discussed at text accompanying notes 73 to 75, deals with an estate that included jointly held property, and Commissioner v. Masterson, 127 F.2d 252 (5th Cir. 1942), discussed at text accompanying notes 46 to 52, deals with community property. However, neither case deals explicitly with the issue whether, upon execution of a mutual will, one or both of the testators made a completed gift tax transfer of an interest in the nonprobate property.

[87]79 T.C. at 1054.

[88]851 F.2d 1005 (7th Cir. 1988).

[89]Estate of Grimes, 54 T.C.M. (CCH) 1, 2 (1987).

[90]Id. at 4.

of the first testator to die. The Tax Court made no explicit distinction between the jointly held real estate and the real estate held individually or as tenants in common. However, in light of the Tax Court's statement concerning the savings accounts and the Commissioner's current position on related transfer tax questions involving the interrelationship of a mutual will and nonprobate assets,[91] the jointly held realty probably was regarded as passing to the survivor outside the will. Therefore, the gift tax probably was computed as though the survivor owned the entire tract immediately after the death of the first testator to die.[92]

A number of other cases and rulings have dealt with the effect of a mutual will upon nonprobate assets in the estate tax context. Although the estate tax consequences of a mutual will are a separate topic,[93] the federal courts' analysis of estate tax issues implies gift tax consequences for the surviving testator at the death of the first testator to die, which are discussed here.

In the estate tax context, the question of the effect of a mutual will upon the transfer of nonprobate assets arises most frequently in connection with a claim that the nonprobate assets qualify for the federal estate tax marital deduction[94] in the estate of the first testator to die if the testators are spouses. It also arises occasionally in cases dealing with the includibility of the formerly jointly held asset in the estate of the surviving testator.[95]

At least since 1971, the Service has taken the position that the nonprobate assets pass to the surviving joint tenant or beneficiary (in the case of life insurance) in accordance with the relevant deed or contract. The mutual will affects the disposition of the nonprobate assets only because, in its contractual aspect, it usually imposes an obligation on the surviving testator to transfer the property to certain individuals at death if the survivor has not previously consumed it. The Service treats nonprobate assets as having passed from the deceased testator to the survivor outright, qualifying for the federal estate tax marital deduction.[96] It then regards the surviving testator as having made a lifetime transfer of a remainder interest in the nonprobate assets to the remainder beneficiaries under the mutual will at the death of the deceased testator, when the mutual will becomes irrevocable. Commonly, the surviving testator retains a life interest in the nonprobate assets. Therefore, the Service holds that the nonprobate assets ultimately are includible in the surviving testator's estate under section 2036(a)(1).[97]

Under this analysis, the surviving testator makes a gift of an interest in the

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[91]See text accompanying notes 96–97.

[92]The opinion of the Court of Appeals contains a footnote stating that the interest of the deceased testator in the real property passed "directly" to the beneficiaries at her death, and that the Commissioner was arguing only for gift taxation of the survivor's interest in the property. 851 F.2d at 1006 n.2. However, this note may refer only to the decedent's interest in property the spouses held as tenants in common, not as joint tenants

[93]See text accompanying notes 151–168.

[94]I.R.C. § 2056(c)(5).

[95]See, for example, Olson v. Reisimer, 271 F.2d 623 (7th Cir. 1959), discussed at text accompanying notes 53–56.

[96]Rev. Rul. 71–51, 1971–1 C.B. 274.

[97]Priv. Ltr. Rul. 7918003 (September 26, 1978).

nonprobate assets at or after the death of the first testator to die. Although some federal courts have adopted this reasoning in resolving these and related transfer tax questions,[98] other courts reason that the first testator to die imposed restrictions on the surviving testator's interest in the deceased testator's share of the jointly held assets, or upon the survivor's interest in life insurance proceeds.[99] For example, several federal courts have held that nonprobate assets that are includible in the estate of one spouse and pass to the other spouse do not qualify for the federal estate tax marital deduction because the terms of the mutual will render the survivor's interest a nondeductible terminable interest. This conclusion is accurate only if the terms of the mutual will are interpreted in one of three ways.

First, the court could regard the mutual will as severing the joint tenancy upon execution of the will. Thereafter, the spouses hold the property as tenants in common. The transfer tax consequences are as follows: Each testator's interest in the property held as tenants in common is a probate asset. The mutual will, speaking as the will of the first testator to die, grants the surviving testator a nondeductible terminable interest in the decedent's share of the property. Under this interpretation, the survivor cannot have made a gift at the death of the first testator to die of the portion of the property includible in the predeceased testator's probate estate because the survivor cannot be a donor of property that (s)he does not own. However, the survivor may have made a completed gift of a remainder interest in his or her share of the tenancy in common property at the death of the first testator to die. The taxation of that gift depends upon whether the mutual will obligates the survivor to leave that half to particular beneficiaries at the survivor's death (which would constitute a completed gift of the remainder at the death of the first testator to die) or grants the survivor unlimited power to consume the property, requiring only that any remaining value at the survivor's death be left to the remainder beneficiaries (which would not involve a gift at the death of the first testator to die). The same transfer tax consequences occur if the mutual will is deemed to sever the joint tenancy at the death of the first testator to die, rather than upon execution.

The second possible interpretation of a mutual will underlying a holding that nonprobate assets do not qualify for the estate tax marital deduction is that execution of the mutual will severs the joint tenancy and immediately conveys one testator's interest in the newly created tenancy in common to the other testator.[100]

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[98]See, for example, United States v. Ford, 377 F.2d 93 (8th Cir. 1967); Awtry's Estate v. Commissioner, 221 F.2d 749 (8th Cir. 1955); McLean v. United States, 224 F. Supp. 726 (E.D. MI 1963), aff'd per curiam, 15 A.F.T.R.2d 1355 (6th Cir. 1965); Schildmeier v. United States, 171 F. Supp. 328 (S.D. IN 1959), and text accompanying notes 151–168.

[99]See, for example, United States v. Spicer, 332 F.2d 750 (10th Cir. 1964); Wilcoxen v. United States, 310 F. Supp. 1006 (D. KS 1969); Lindsey v. United States, 167 F. Supp. 136 (D. MD 1958); Estate of Peterson v. Commissioner, 23 T.C. 1020, rev'd per curiam, 229 F.2d 741 (8th Cir. 1955).

[100]If the testators are spouses, these constructions produce different estate tax consequences after 1981 than under prior law because the unlimited marital deduction is available with respect to any portion of the jointly held asset that is deemed to pass by virtue of severance. If there is no severance, under prior law all of the jointly held property would be subject to inclusion in the estate of the first

The testator who owns the property then dies first and the mutual will, speaking as that testator's will, grants the survivor a nondeductible terminable interest in the entire asset. Under this interpretation, the survivor incurs no gift tax consequences at the death of the first testator to die because (s)he transferred nothing at that time.

The third possible construction of a mutual will that would support a holding that nonprobate assets do not qualify for the estate tax marital deduction is that the testators intended that the nonprobate assets pass to the surviving testator outside of the will of the first testator to die, subject to a contractual obligation, created by the mutual will, restricting the survivor's ultimate disposition of those assets. The surviving testator receives the property subject to an obligation to transfer it to others and, for transfer tax purposes, the property interest of the ultimate takers in the deceased testator's share of the property is deemed to pass directly from the deceased testator to those takers. Therefore, the survivor's interest in the predeceased testator's share of the property does not qualify for the estate tax marital deduction.[101] This interpretation eliminates the need to explain the estate tax result by finding constructive severance of the joint tenancy. The gift tax consequences to the surviving testator ought to be the same as they are if the mutual will is construed as severing the joint tenancy: The survivor has only a life interest in the predeceased testator's share of the property; therefore, the survivor makes no gift of the remainder at the predeceased testator's death. However, the survivor makes a gift of the remainder in his or her interest in the property if the mutual will obligates the survivor to leave the property to certain beneficiaries at his or her death.

In most instances, the surviving testator will enjoy the same benefits from the property regardless of which of the foregoing analyses is applied for transfer tax purposes. Therefore, the mutual will should be construed for gift tax purposes in a manner that is most consistent with the language of the will. If the mutual will does not explicitly state that the testators intend to sever joint tenancies, no severance should be inferred. Furthermore, if the will does not explicitly state that it binds the survivor concerning disposition of nonprobate assets, the survivor should not be deemed to have made a gift of a remainder interest in such assets at the death of the first testator to die. Lastly, as to mutual wills that explicitly address nonprobate assets, careful analysis of the will is necessary to determine the scope of the survivor's obligation. The analysis is the same with respect to nonprobate assets as it is with respect to the survivor's separate assets: a determination that the survivor has made a taxable gift to the ultimate beneficiaries at the death of the first testator to die depends upon the extent to which the surviving testator has relinquished control over further disposition of the asset.

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testator to die under the consideration furnished test of section 2040(a) and no more than half of that property could have qualified for the marital deduction under former section 2056(c). Since 1981, only half of the jointly held property would be includible in the estate of the first testator to die under section 2040(b), and all of that half potentially would be deductible under section 2056.

[101] I.R.C. § 2056(b)(1).

Disclaimers and Elections Against the Will

Since the enactment of section 2518 in 1976,[102] disclaimers have become a very important post-mortem estate planning tool.[103] For example, they are used frequently to adjust the over- or underfunding of the estate tax marital deduction,[104] or to eliminate interests from trusts that otherwise would prevent marital deduction qualification,[105] and disclaimers are being used for generation-skipping planning as well.[106] The justification for failing to tax a disclaimed interest as a gift by the disclaimant is that the disclaimant has refused to accept the disclaimed interest and, therefore, makes no transfer.[107]

May the surviving testator of a mutual will effectively disclaim an interest passing under the will? The answer clearly should be yes. Contractual obligations to deal with the property in certain ways during life and at death should not affect the validity of a disclaimer for federal transfer tax purposes or under state property law. Such contractual obligations ordinarily will preclude the surviving testator from reducing the interests of third parties. Because a disclaimer reduces the surviving testator's benefits under the will and increases or accelerates receipt of the benefits due others, a testator's interest under a mutual will clearly ought to be disclaimable.[108] To date, however, there has been no federal litigation directly on

[102]Tax Reform Act of 1976, Pub. L. No. 94–455, § 2009, 90 Stat. 1520, 1893 (1976) (prior to 1978 and 1981 amendments).

[103]See, for example, J. Farr and J. Wright, An Estate Planner's Handbook 311–314 (4th ed. 1979); LaPiana & Brand, Final Disclaimer Regulations Offer Flexibility in the Use of General Powers of Appointment for the Marital Deduction, 65 Taxes 133 (1987); Moore, Post-Mortem Planning & Administration for Unlimited Marital Deduction Estates, 20 U. Miami Inst. on Est. Plan. ¶ 1201 (1986).

[104]For example, Priv. Ltr. Rul. 8914045 (January 6, 1989) (beneficiaries' timely disclaimer of interests in decedent's estate increased marital deduction by increasing property passing outright to surviving spouse); Priv. Ltr. Rul. 8910043 (December 8, 1988) (surviving spouse's timely disclaimer of portion of property decedent bequeathed to her reduced amount of property qualifying for marital deduction because disclaimed property passed to decedent's son). For an excellent discussion of uses of disclaimers in post-mortem marital deduction planning, see 4 A. Casner, Estate Planning § 13.13.5 (5th ed. 1988).

[105]For example, Priv. Ltr. Rul. 8935024 (June 5, 1989) (surviving spouse's timely disclaimer of nongeneral power to appoint trust property to children qualified spouse's remaining interests in trust for QTIP election); Priv. Ltr. Rul. 8906036 (November 11, 1988) (timely disclaimer by decedent's children of income interests in trust qualified surviving spouse's interest in trust for QTIP election).

[106]For example, Priv. Ltr. Rul. 8946060 (August 23, 1989) (timely disclaimer by skip person resulted in direct skip from grantor to grantor's grandchildren); Priv. Ltr. Rul. 8907028 (November 21, 1988) (timely disclaimer by grantor's surviving spouse resulted in direct skip from grantor to grantor's grandchildren); 3A A. Casner, Estate Planning § 11A.11 (5th ed. 1986 and 1989 Supp.); Halbach, Living With the Generation-Skipping Transfer Tax, 22 U. Miami Inst. on Est. Plan. ¶ 1000 (1988).

[107]H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., II–771, reprinted in 1987 U.S. Code Cong. & Admin. News 4075, 4859.

[108]Even if a disclaimer contravenes the estate plan anticipated by the mutual will it still should be effective for tax and property law purposes. It may, however, be a unilateral rescission of the contract between the testators, rendering the survivor liable for breach of contract.

point, although the Tax Court[109] and the Service[110] have ruled on related matters in a manner that is consistent with this analysis.

It might be questioned whether a disclaimer is timely if filed by the surviving testator after the death of the first testator to die. Section 2518(b)(2)(A) requires that, to make a qualified disclaimer, the disclaimant must act within nine months of "the date on which the transfer creating the interest in [the disclaimant] is made . . . ."[111] If the rights of the surviving testator emanate from the contract, then the disclaimer might be untimely unless filed within nine months of execution of the mutual will. The only ruling on the subject of disclaimers under mutual wills does not address this question.[112] Because a mutual will ordinarily is revocable by either testator during their joint lives, the question should be resolved as it would be in the case of a disclaimer of a revocable interest, in which case the nine month period begins to run from the date the transfer becomes irrevocable.[113] With respect to the interest of the surviving testator under a mutual will, that date is as of the death of the first testator to die.

Two trial courts[114] and the Service[115] have considered the related question of the appropriate transfer tax effect of an election against a mutual will filed by the surviving testator under a state law surviving spouse's election statute.[116] The Service and the Tax Court refused to recognize the election for transfer tax purposes because recognition of the election would permit the surviving spouse unilaterally to rescind the contract made when the testators signed the mutual will; the district court held that the election was not timely filed, but also noted that execution of a mutual will might be construed as consent to the will's terms, thereby precluding election under applicable state law.[117] In each case the election appar-

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[109]Estate of Anderson v. Commissioner, 56 T.C.M. (CCH) 78 (1988), upheld a partial disclaimer by the surviving testator under a mutual will.

[110]Priv. Ltr. Rul. 8015015 (December 28, 1979), involving a joint will that the Service found to be contractual under state law, granted a charitable deduction in the estate of the first joint testator to die for property passing to charity by virtue of a disclaimer filed by the surviving joint testator.

[111]I.R.C. § 2518(b)(2)(A).

[112]Priv. Ltr. Rul. 8015015 (December 28, 1979).

[113]Treas. Reg. § 25.2518–2(c)(3). Similarly, in the case of property held as joint tenants with right of survivorship, the nine-month period begins to run at the death of the first joint tenant, rather than upon initial acquisition of the joint interest. See, for example, Estate of Dancy v. Commissioner, 872 F.2d 84 (4th Cir. 1989); Estate of MacDonald v. Commissioner, 853 F.2d 1494 (8th Cir. 1988); Kennedy v. Commissioner, 804 F.2d 1332 (7th Cir. 1986).

[114]Schmidt v. United States, 279 F. Supp. 811 (D. KS 1968); Estate of Elson v. Commissioner, 28 T.C. 442 (1957).

[115]Priv. Ltr. Rul. 8347002 (July 8, 1983).

[116]See, for example, U.P.C. § 2–201.

[117]A state probate court had accepted the election in both *Schmidt* and *Elson*. 279 F. Supp. at 812; 28 T.C. at 444. The federal courts held that they could redetermine the state law question when evaluating the federal tax question. 279 F. Supp. at 814; 28 T.C. at 446. In *Schmidt*, the district court, after stating that Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), required it to make an independent investigation of the applicable state (Kansas) law, determined that the probate court had erred in accepting the election because the election was not filed within six months of the probate of the will as required by Kans. Stat. Ann. § 59–2233. The court also noted that execution of a mutual will might have constituted consent to the pattern of disposition in the will, thereby precluding an election un-

ently was made to obtain or increase the federal estate tax marital deduction in the estate of the deceased testator. The decisions construed the applicable wills as granting the surviving testator a nondeductible terminable interest[118] and the election resulted in a portion of the property passing outright to the survivor. Thus, the election increased the interest of the surviving testator and reduced the interests of the other beneficiaries of the will. Whether this constitutes a breach of the contract depends upon the terms of the contract.

Most mutual wills fall into two categories: those that limit the surviving testator's interest in the family assets to a life estate, and those that grant full control of the testators' assets to the survivor, subject only to the requirement that what remains at the survivor's death be left to certain beneficiaries. If the will is construed as transferring all the testators' assets to the surviving testator subject only to the requirement that the survivor leave what is left at his or her death in a specified manner, then an election against the will would not violate the mutual will contract. Therefore, a timely election should be recognized for estate tax purposes.

If the contract between the testators is construed to limit the interest of the survivor to a life estate, then an election against the will breaches the contract if it permits the survivor to obtain a portion of the assets outright. Nevertheless, the fact that such an election constitutes a breach of contract for state law purposes does not justify disregarding the election for federal transfer tax purposes. The probate court accepted the election as filed in both cases discussed above. No beneficiary objected to the probate courts' acceptance of the elections. However, the probate courts probably could not have refused to accept the election, if a beneficiary had raised the contract issue, because probate courts do not have jurisdiction to hear breach of contract claims. Mutual will contract disputes must be litigated in a court of general jurisdiction.[119] Because the federal courts' determination of the invalidity of the elections conflicted with the probate courts' acceptance of them, the surviving spouses in both

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der Kansas law; however, the court declined to rule on the issue of consent. Although *Elson* was decided before *Bosch*, the Tax Court held that it had authority to redetermine the validity of the election because the state court proceeding was collusive. 28 T.C. at 446. Upon examining the applicable state (Iowa) law, the Tax Court determined that permitting the first testator to die with a mutual will in place "fixed" the interest of the surviving testator in the testators' assets and rendered "her attempted revocation by electing to take the statutory interest . . . a nullity." 28 T.C. at 445.

[118]Priv. Ltr. Rul. 8347002 (July 8, 1983) directed the District Director to determine whether the will was contractual under state (Illinois) law. It stated, however, that the will probably was contractual and that, if it was, it granted a nondeductible terminable interest to the surviving testator. Therefore, the estate of the first testator to die could claim no marital deduction unless the election against the will was recognized.

The will in question provided the surviving testator with a life estate and a general testamentary power of appointment over the entire estate, which is a form of deductible terminable interest. See I.R.C. § 2056(b)(5). The Ruling reasoned that the obligations of the contract rendered the interest a nondeductible terminable interest, citing Opal v. Commissioner, 450 F.2d 1085 (2d Cir. 1971), and Krampf v. Commissioner, 56 T.C. 293 (1971), aff'd per curiam, 464 F.2d 1398 (3d Cir. 1972), which dealt with mutual wills and are discussed at text accompanying notes 144–147.

[119]Accord, Oursler v. Armstrong, 179 N.E.2d 489 (NY 1961); In re Estate of Baughman, 170 N.E.2d 557 (IL 1960); see generally Sparks at 124–134 and 167–178 (cited in note 1).

cases received a portion of the estates outright, but the estates were unable to deduct those distributions. A more reasonable solution would recognize the election for purposes of determining the estate tax on the estate of the first testator to die, and then assess a gift tax upon the other beneficiaries for the value of the property they permitted the surviving spouse to take by failing to object to the election,[120] *if* an objection would succeed under state law.

Close scrutiny of the facts involved in the three existing decisions generates some doubt about their value as precedent. In *Elson* the wills limited the interest of the surviving testator to a life estate but were not clearly contractual.[121] The will in *Schmidt* contained a clause explicitly stating that the spouses accepted the provisions of the will in lieu of any statutory rights either spouse might have in the other's estate.[122] The terms of the will in the Letter Ruling are not quoted, but the Ruling states that the will granted the survivor a life estate and a general testamentary power of appointment and that the survivor was contractually bound to leave the property to named individuals.[123] If the analysis here were applied to these three fact patterns, the election would be recognized for transfer tax purposes in the first two situations but the failure to object to the election in the second case would be treated as a taxable gift by the remainder beneficiaries to the surviving spouse. The terms of the third will conflict irreconcilably; either the will was not

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[120]Cf. Estate of Lang v. Commissioner, 613 F.2d 770 (9th Cir. 1980) (mother made taxable gift to son when she permitted the statute of limitations to expire upon her right to collect on demand loans made to son); Rev. Rul. 84–105, 1984–2 C.B. 197 (underfunding of marital share without timely disclaimer constituted taxable gift from surviving spouse to residuary legatees).

[121]Estate of Elson v. Commissioner, 28 T.C. 442 (1957). The will in *Elson* contained a clause that granted each testator the right to revoke or amend his or her will "at any time as it relates to the disposition of his or her own property" without the consent of the other. Id. at 443. After making its own study of the relevant state (Iowa) law, the Tax Court concluded that this clause merely recited Iowa law concerning mutual wills and did not change this will's contractual nature. Iowa courts have reasoned that a contractual will must be revocable by either testator after notice to the other testator because a will is ambulatory and, therefore, revocable until the death of the testator. This statement is correct, but may not clarify the nature of the Elson will. It does not follow that, because each testator's will is unilaterally revocable until the death of that testator, the testators' contract to leave their property in a certain way also is unilaterally revocable, even after one of the testators has performed by dying with the will in place. Therefore, the statement concerning revocability might have been intended in either of two ways: The Elsons might have intended to contract for a particular disposition of their assets, and the clause granting each testator the right to revoke his or her will unilaterally may have been boilerplate language intended, as the Tax Court found, merely to reiterate state law. In that case, although either testator could have revoked his or her will at any time, a surviving testator who revoked after the death of the first testator to die might be liable in damages to the ultimate beneficiaries of the disposition that the testators contracted for. Even under this interpretation, however, the surviving testator would have the power to elect against the deceased testator's will, but the election might constitute a breach of the contract to the extent it reduced the interest of other beneficiaries in the deceased testator's assets.

On the other hand, the testators might have granted each other the right to revoke the will because they intended to execute a joint, but not a mutual, will. In that case, there would be no reason to refuse to recognize the surviving spouse's election against the deceased testator's will for any purpose, including for the purpose of allowing the marital deduction.

[122]Schmidt v. United States, 279 F. Supp. 811, 813 (D. KS 1968).

[123]Priv. Ltr. Rul. 8347002 (July 8, 1983).

contractual or it was contractual but the contract was unenforceable because it was an invalid contract to exercise a testamentary power of appointment.[124]

ESTATE TAX CONSEQUENCES

At the Death of the First Testator to Die

The Marital Deduction

Nonterminable Interests

By far the greatest number of cases dealing with the transfer tax consequences of mutual wills deal with whether property passing under such a will to the surviving testator can qualify for the federal estate tax marital deduction if the testators are spouses. Until the addition of section 2056(b)(7) to the Code in 1981,[125] permitting a naked life estate in property to qualify for the marital deduction, there were essentially three ways that property passing to a surviving spouse could qualify for the marital deduction: it could be transferred outright to the survivor,[126] it could pass in a manner that granted the survivor the interests required by sections 2056(b)(5) and 2056(b)(6), each involving a life estate in a trust or its equivalent together with a general power of appointment over the corpus involved (or a legal life estate with power to consume the principal that had the same characteristics), or it could mirror the disposition described in Revenue Ruling 68-554,[127] which involved a so-called "estate" trust by which the surviving spouse is the sole beneficiary of a trust that is payable to the spouse's estate when the spouse dies. The chief question with respect to any form of disposition is whether the arrangement grants the requisite enjoyment or, instead, constitutes a "nondeductible terminable interest."

This inquiry has special ramifications if the property passes pursuant to a mutual will because the surviving testator may have contractual obligations to pass the property to other beneficiaries after death, even if it was received outright. Therefore, prior to the enactment of section 2056(b)(7) the risk was much greater that an interest in property passing under a mutual will would fail to qualify for the marital deduction. Determination of whether an interest passing under a mutual will qualifies for the marital deduction as a deductible terminable interest is substantially less significant today because property in which the surviving spouse has only a life estate now can qualify for the marital deduction if the proper election is made under section 2056(b)(7). Therefore, section 2056(b)(7) will be dealt with first below.

Qualified Terminable Interests In Property—Section 2056(b)(7)

Section 2056(b)(7) provides an additional method of passing property to a surviving spouse that will qualify the property for the federal estate tax marital

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[124]Restatement (Second) of Property § 14.1 (1986 and Supp. 1987–1988).

[125]P.L. No. 97–34, § 403(d)(1), 95 Stat. 172, 302 (1981).

[126]I.R.C. § 2056(a).

[127]1968–2 C.B. 274.

deduction: the "qualified terminable interest in property" (QTIP). At least one commentator believes that property passing under a mutual will can qualify for the marital deduction under this new provision.[128]

The requirements of section 2056(b)(7) are similar to those of section 2056(b)(5) except that the surviving spouse need not have a power to control the disposition of the qualifying property. Instead, the personal representative of the estate of the first testator to die may elect to have property qualify for the marital deduction in the decedent's estate, provided that the survivor is entitled to all of the income from the property for life and no one other than the survivor may appoint the property to anyone other than the survivor.[129] Property for which such an election is made is subject to taxation when the survivor disposes of it, either by lifetime gift or at death.[130]

The principal impediment to qualification for the marital deduction under sections 2056(a) and 2056(b)(5) of property passing from one spouse to another under a mutual will is that the survivor is contractually bound to transfer the property in accordance with the terms of the mutual will. Because of the contractual obligation, the survivor's interest in the property passing under the will is rarely seen as equivalent to outright ownership, and may be construed as no more than a life estate. Section 2056(b)(7) eliminates this impediment. Clearly, property bequeathed under a testator's noncontractual will qualifies for the election under section 2056(b)(7), if the surviving spouse has the requisite right to the income, even if the will explicitly provides for disposition of the property to others at the survivor's death. Therefore, the interest passing to a surviving testator under a mutual will should qualify, regardless of the provisions dealing with the remainder, provided that the surviving testator has the requisite income interest and no one has a prohibited power to appoint the property to anyone other than the survivor.

A mutual will does not make it easier to qualify under the QTIP provisions. Nevertheless, the QTIP election might save the marital deduction for the estate of an already deceased testator who left assets pursuant to a mutual will: the interests of the survivor in each case that denied the marital deduction under section 2056(b)(5) would have qualified for the election under new section 2056(b)(7).[131]

The surviving testator may prefer to have her[132] interest in the testator's property treated as a life estate coupled with a general power of appointment rather than as QTIP property because the gift tax consequences of exercising the general power of appointment during life are different from the gift tax consequences of transferring an interest in QTIP. Transfer of any interest in QTIP property apparently requires payment of gift tax on the fair market value of all of the remainder

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[128]Dobris, Do Contractual Will Arrangements Qualify for Qualified Terminable Interest Treatment Under ERTA? 19 Real Prop., Prob. & Tr. J. 625 (1984).

[129]I.R.C. § 2056(b)(7)(B).

[130]Id. § 2044, 2519.

[131]See text accompanying notes 138–150 and cases cited therein.

[132]For clarity, the surviving testator is referred to as "she" in the material dealing with the marital deduction, unless the survivor was the husband in the particular case analyzed.

interest in QTIP property on the date of gift,[133] while partial exercise of a general power of appointment results in gift tax only on the property transferred.[134] Furthermore, the holdings in the cases decided under section 2056(b)(5) have implications for other transfer tax issues discussed in this article. Therefore, the cases dealing with qualification for the marital deduction under section 2056(b)(5) are discussed below.

Section 2056(b)(5)—Deductible Terminable Interests

Cases involving determination of whether interests under mutual wills are deductible terminable interests under section 2056(b)(5) can be grouped into categories according to the form of the bequest to the surviving spouse. Essentially, bequests fit into three groups: at the end of the spectrum closest to outright ownership are bequests purporting to leave the property outright to the surviving testator but providing a gift over after her death. At the opposite end of the spectrum are bequests that seem most likely to constitute nondeductible terminable interests, which limit the survivor's interest to a life estate. In the middle are those bequests that grant the survivor a life estate together with a power to consume the property, followed by a bequest to others of the assets that remain at the survivor's death. Resolution of the marital deduction issue depends upon construction of the bequest under applicable state law. If the bequest makes an unencumbered outright transfer to the surviving testator, the survivor's interest will qualify for the marital deduction under section 2056(a). If the bequest grants the survivor no more than a life interest, even if coupled with a limited power to consume the underlying property, the interest of the survivor is a nondeductible terminable interest that cannot qualify for the marital deduction unless a section 2056(b)(7) QTIP election is made. Courts resolving tax disputes before this QTIP alternative was adopted had little difficulty finding that mutual wills that explicitly convey a naked life estate to the survivor created nondeductible terminable interests for which the marital deduction was not allowable.[135]

Prior to the adoption of section 2056(b)(7), difficulties arose in determining whether testators who convey property to a surviving testator absolutely but who also provided for disposition of the property after the survivor's death intended to convey outright ownership to the survivor and, if not, whether the interest conveyed qualified as a life estate coupled with a sufficient power of appointment to qualify for the deduction under section 2056(b)(5). Once a court has determined that a will is mutual, it rarely will find that the will gives the survivor unfettered outright ownership of the subject property, apparently because the court infers that the parties contracted to bind the survivor to preserve the property for the ultimate beneficiaries. The alternative of finding that, although the will is mutual, the survivor receives the assets outright with no obligation to the ultimate beneficiaries (that is, that the will is not contractual with respect to ultimate disposition

[133] I.R.C. § 2519(a).

[134] Id. § 2514(b).

[135] Cf. Wilcoxen v. United States, 310 F. Supp. 1006 (D. KS 1969); Lindsey v. United States, 167 F. Supp. 136 (D. MD 1958).

of the property) apparently has not been considered by courts deciding transfer tax questions. There is no reason, however, why testators could not be deemed to have contracted concerning disposition of their property following the death of the first to die, but not to have intended to bind the survivor to any particular subsequent disposition.

If the court determines that the survivor received something less than unfettered ownership of the deceased testator's property despite use of the term "in fee simple" or "outright" in the will, the court then must decide what these terms mean. There are three possibilities: First, the deceased testator intended to convey less than outright ownership to the survivor despite the use of the word "outright;" second, the deceased testator intended to convey outright ownership to the survivor, and the phrase following the conveyance is precatory only and not contractual;[136] or third, the intent of the deceased testator is irrelevant and the will must be construed in accordance with traditional rules of construction. A court that chose the third alternative might apply the rule of repugnance, a tenet of construction that disregards limiting language that follows a conveyance in fee simple on the grounds that the limiting language is "repugnant" to the grant in fee simple.[137] Courts deciding tax cases generally have avoided basing the transfer tax consequences of a mutual will upon a finding that the remainder is void under the doctrine of repugnance, probably because such a finding requires a determination that the language concerning ultimate beneficiaries is surplus, and has no meaning at all.

Several cases have denied the marital deduction in the estate of the first testator to die, even under a mutual will that purported to grant the surviving testator a fee simple but that also contained provisions for those designated to receive the family assets after the death of the survivor.[138] The courts' rationale in each case was that the interest of the surviving testator was limited by the mutual will contract in two respects: The survivor was prohibited from making an inter vivos gift of the transferors' property, and was obligated to preserve the estate for the benefit of the ultimate takers. Consequently, the survivor did not receive an unfettered right to consume the deceased testator's property and, therefore, did not receive a bequest that qualified for the marital deduction. The courts in each case justified their reading of the mutual will on the ground that it was the only reasonable interpretation of the intent of the testators; that is, the mutual will contract would have been meaningless if the ultimate beneficiaries could not enforce an entitlement to the property against the surviving testator. This interpretation of the intent of the testators of a mutual will is unduly narrow. The same language can be read to indicate that each testator wished the other to have complete discretion to

[136]See Sparks at 117 (cited in note 1). Several courts have taken the fact that the survivor receives the deceased testator's assets outright as an indication that the will is not contractual. Dekker v. United States, 245 F. Supp. 255 (S.D. IL 1965); Estate of Aquilino v. Commissioner, 31 T.C.M. (CCH) 906 (1972).

[137]See, for example, Fox v. Snow, 76 A.2d 877 (NJ 1950).

[138]Estate of Abruzzino v. Commissioner, 61 T.C. 306 (1973); Estate of Peterson v. Commissioner, 23 T.C. 1020, rev'd per curiam, 229 F.2d 741 (8th Cir. 1955).

use the property during life, provided only that, if there was anything left to bequeath, it would pass to the named beneficiaries. Thus, the beneficiaries' right against the survivor properly may be construed as limited to preventing transfer of the remaining property to others at the survivor's death,[139] and such a restriction on the survivor would not cause a reduction in or disallowance of the marital deduction.

An interesting question that does not seem ever to have been considered in determining whether interests passing under mutual wills qualify for the marital deduction is whether to treat the question as affecting only valuation and not qualification. The argument can be made that property passing under a mutual will from the deceased testator to the surviving testator subject to a contractual obligation to transfer an interest in the property to others is similar to property subject to a debt, such as a mortgage. Under section 2056(b)(4) such property qualifies for the marital deduction, but the amount of the deduction is reduced by the amount of the debt. If the obligation imposed upon the surviving testator by the mutual will is capable of valuation, the argument goes, the amount qualifying for the marital deduction is the excess of the fair market value of the property over the fair market value of the obligation. It may be appropriate to treat some obligations imposed by mutual wills as debts for this purpose. Examples of obligations that appropriately would be treated in this manner are an obligation to pay an annuity, or to make annual or other periodic transfers of part of the property to individuals named in the mutual will. On the other hand, if the survivor's obligation is to preserve the entire property and transfer it at death (or at some other specified time) to named individuals, the survivor's interest is indistinguishable from a life estate. Therefore, to value the obligation, which is presumably equal to the value of the remainder interest in the property following the survivor's life (or the specified term of years), and to permit a marital deduction for the excess of the fair market value of the property over the value of the obligation, would permit a marital deduction for a naked life interest without requiring a QTIP election. Clearly, such an interpretation of section 2056(b)(4) invites use of mutual wills to achieve tax avoidance that cannot be achieved by execution of individual wills.

Even courts that find that the surviving testator has an unlimited power of consumption under a mutual will must grapple with an unfortunate but universally-held interpretation of the requirements of section 2056(b)(5) concerning the survivor's general power of appointment. Section 2056(b)(5) requires only that the survivor receive an inter vivos or testamentary power, exercisable by the survivor alone and in all events. The Regulations under section 2056 state that an unlimited power to consume property during life is sufficient to qualify the subject property for the marital deduction[140] but that an inter vivos power is

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[139]See Sparks at 116–119 (cited in note 1).

[140]Treas. Reg. § 20.2056(b)–5(g)(1)(i).

not exercisable "in all events" if it cannot be exercised to make a gift of the property.[141]

The critical question, in determining whether any interest qualifies for the marital deduction, clearly should be whether the survivor has an unlimited power to consume during life. If she does, then the property will be includible in the survivor's estate at death under section 2041, and there is no reason to deny the marital deduction at the death of the first testator to die. Unfortunately, courts generally have accepted the Regulation requiring the survivor to have the power to make gifts as a proper construction of the statutory phrase "alone and in all events" in section 2056;[142] indeed, some have explicitly rejected the argument that Congress could not have intended double taxation to occur by denying the marital deduction and requiring inclusion in the survivor's estate.[143]

The discrepancy in the application of sections 2056 and 2041 is an unnecessary trap for the unwary. Congress should amend section 2056(b)(5) to provide that a power taxable to the powerholder under section 2041 will qualify the appointive property for the marital deduction. Until section 2056 is amended, however, a mutual will does not confer an interest on the surviving testator that can qualify for the marital deduction under section 2056(b)(5) if the contractual aspect of the will is deemed to preclude inter vivos gifts.

Furthermore, whether particular language permits the surviving testator to make gifts may be difficult to determine. For example, in *Estate of Opal v. Commissioner,*[144] the Court of Appeals for the Second Circuit denied the marital deduction in the estate of the deceased testator under a mutual will on the ground that the survivor could not change the identity of the ultimate beneficiary of property received under the mutual will. The will in *Opal* granted the deceased testator's entire estate to the survivor "absolutely and forever" but also specified that, upon the death of the survivor, the entire estate was to go to the testator's son "absolutely and forever."[145] The court reasoned that the survivor could make neither a lifetime gift nor a testamentary bequest of the property received from the decedent to anyone other than the testators' son without violating the contract embodied in the mutual will.[146] Therefore, the survivor's interest was regarded as insufficient to qualify the property for the marital deduction in the deceased testator's estate, even though there was nothing in the language of the will that imposed any limit upon the survivor's use or consumption of the property for the

[141] Id. § 20.2056(b)–5(g)(3).

[142] See R. Stephens, G. Maxfield, & S. Lind, Federal Estate and Gift Taxation §§ 5–97—5–99 (5th ed. 1983) and cases cited therein.

[143] See, for example, Estate of Opal v. Commissioner, 450 F.2d 1085, 1088 (2d Cir. 1971); Pipe's Estate v. Commissioner, 241 F.2d 210, 214 (2d Cir. 1957).

[144] 450 F.2d 1085 (2d Cir. 1971).

[145] Id. at 1086.

[146] Id. at 1088.

survivor's own benefit during life. The Court of Appeals for the Third Circuit and the Tax Court have rendered similar opinions.[147]

In contrast to *Opal*, the Court of Appeals for the Tenth Circuit in *United States v. Spicer*[148] held to qualify for the marital deduction a bequest in a mutual will that gave the surviving spouse[149]

> the right to sell and convey the property so devised, and to invest and re-invest the proceeds thereof as the survivor shall deem to the best interest of our estate. But any such property or investments, in whatever form they remain, at the death of the survivor of us, shall pass to, and we devise and bequeath the same as hereinafter provided.

The will bequeathed the testators' residuary estate to their children. The court of appeals upheld the district court's interpretation of this clause as granting the surviving testator an unfettered power of disposition over the testators' assets, in light of evidence of the testators' intent and applicable (Kansas) law governing mutual wills.[150]

A comparison of *Opal* and *Spicer* illustrates the construction problem inherent in determining whether bequests under mutual wills qualify for the marital deduction under section 2056(b)(5). The language of the two wills is quite similar; indeed, if either can be construed to preclude inter vivos gifts of the testators' assets by the surviving testator, the language of the will in *Spicer* seems more likely to impose such a limitation than that in *Opal*. At issue is the scope of the contract between the testators, a question that must be answered under the applicable state law. Did they contract to leave certain assets to named beneficiaries, as the first group of cases implies? Did they contract merely to leave whatever remained at the death of the survivor? Or did they contract only to leave the testators' assets to the survivor, with the residuary clause meant to function only as the will of the survivor and not as a part of a contract at all? Until a federal court resolves these matters of intent under state law principles of construction, it cannot accurately resolve the federal transfer tax question.

Nonprobate Assets

One of the most frequently litigated questions in this area is the extent to which property held jointly by spouses may qualify for the marital deduction if the spouses have executed a mutual will. Resolution of the question requires a two-part analysis. The federal court must first determine whether the mutual will obligates the surviving testator to dispose of the deceased testator's share of the

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[147]Estate of Krampf v. Commissioner, 464 F.2d 1398 (3d Cir. 1972); Estate of Siegel v. Commissioner, 67 T.C. 662 (1977); see also Estate of Peterson v. Commissioner, 23 T.C. 1020, rev'd per curiam, 229 F.2d 741 (8th Cir. 1955).

[148]332 F.2d 750 (10th Cir. 1964). See also First National Bank of Janesville v. Nelson, 233 F. Supp. 860 (E.D. WI 1964), and Nettz v. Phillips, 202 F. Supp. 270 (S.D. IA 1962), in which the surviving testators were held to have powers of appointment that qualified the subject property for the marital deduction under Code section 2056(b)(5) in the estates of the deceased testators because the surviving testators had full power "to dispose of" the property during life; however, the courts did not discuss whether the power of disposition included the power to give the property away.

[149]332 F.2d at 751.

[150]Id. at 753–754.

survivorship property in a particular way. If it does, then the court must determine whether the surviving testator receives a nondeductible terminable interest in the deceased testator's share of the property because of this obligation. The Service initially took the position that a mutual will, speaking as the deceased testator's will, governed the nature of the interest of the surviving testator in jointly held property,[151] and this position prevailed in several decisions.[152] Nevertheless, federal courts generally have held that the jointly held property passes outside the will to the survivor outright.[153] Those courts that have so held uniformly also have held that the jointly owned assets qualify for the marital deduction in the estate of the deceased testator, even if the surviving testator's interest in probate assets subject to the mutual will is concededly nondeductible.[154] Apparently, the Service has conceded this issue[155] and has begun to focus instead on the gift tax ramifications to the surviving testator of the ultimate transfer of the property to the designated remainder beneficiaries.[156]

The courts' analysis of the testators' intent concerning disposition of nonprobate property is rather superficial. The key question is whether the mutual will imposes restrictions upon the survivor's use of the nonprobate property and upon the survivor's ultimate disposition of the property. The resolution of this question turns upon a determination of the intent of the mutual testators. The mutual will may impose restrictions upon the survivor's disposition of the nonprobate property sufficient to disqualify the property for the marital deduction, absent a QTIP election, regardless of whether the nonprobate property passes outside the will for state probate law purposes. If a joint tenancy is severed at the execution of a mutual will, then the testators hold the property thereafter as tenants in common until the first testator's death. The mutual will might be construed to convey an interest in the deceased testator's share of the property to the surviving testator. If that is the case, then the surviving testator's share of the property is not includible in the estate of the deceased testator for transfer tax purposes, and the decedent's share is a probate asset, subject to the terms of the mutual will that govern the transfer of assets generally from the deceased testator to the survivor. Whether the survivor receives a nondeductible terminable interest in the portion that is includible in the deceased testator's estate depends upon a construction of the terms of the will under the analysis that applies to the deceased testator's other property. If execution of the mutual will severs the joint tenancy and conveys one

[151]See, for example, Priv. Ltr. Rul 6612201580A (December 20, 1966); Priv. Ltr. Rul. 6402041580A (February 4, 1964).

[152]See, for example, United States v. Spicer, 332 F.2d 750 (10th Cir. 1964); Wilcoxen v. United States, 310 F. Supp. 1006 (D. KS 1969); Lindsey v. United States, 167 F. Supp. 136 (D. MD 1958); Estate of Peterson v. Commissioner, 23 T.C. 1020, rev'd per curiam, 229 F.2d 741 (8th Cir. 1955).

[153]See, for example, United States v. Ford, 377 F.2d 93 (8th Cir. 1967); Awtry's Estate v. Commissioner, 221 F.2d 749 (8th Cir. 1955); McLean v. United States, 224 F. Supp. 726 (E.D. MI 1963) aff'd per curiam 15 A.F.T.R. 2d 1355 (6th Cir. 1965); Schildmeier v. United States, 171 F. Supp. 328 (S.D. IN 1959).

[154]See, for example, Awtry's Estate v. Commissioner, 221 F.2d at 760.

[155]Rev. Rul. 71-51, 1971-1 C.B. 274.

[156]See, for example, Priv. Ltr. Rul. 7921001 (undated); Priv. Ltr. Rul. 7810001 (August 11, 1977).

testator's interest in the property to the other, then the analysis is the same except that the entire property is a probate asset in the transferee testator's estate. If that testator dies first, then the entire property is governed by the terms of the mutual will that govern disposition of the deceased testator's assets, and qualification of the surviving testator's interest in the property for the marital deduction will depend upon a construction of those terms under the analysis that applies to the deceased testator's other property. Mutual wills should not, however, be construed to sever a joint tenancy unless they so state explicitly.[157]

If joint tenancy property is not severed when a mutual will is executed, then the entire property must belong to the surviving testator outright by right of survivorship. If that is the case, and if the mutual will is not construed to impose upon the survivor an obligation to make a future transfer of the property to beneficiaries named in the mutual will, property held jointly by spouses clearly should qualify for the marital deduction, to the extent that it is includible in the deceased testator's estate.[158] To determine whether such a binding obligation exists, a court evaluating the federal transfer tax consequences must determine the terms of the contract between the testators. If the obligation was not previously binding but becomes binding when the first testator dies with a will containing the contracted provisions, then the survivor receives the entire property outright simultaneously with the obligation to transfer it at death to the beneficiaries named in the mutual will. Rather than engage in an arcane, and likely fruitless, attempt to discover which event—receipt of the property or imposition of the obligation—occurred first, the federal courts would do well to adopt a simpler approach, and merely follow the actual title to the property. Under such an analysis, the property would be treated as having passed outright to the survivor under the deed and, therefore, would qualify for the marital deduction. The survivor's obligation to transfer the property to the named beneficiaries at death then would be treated as becoming binding immediately after receipt of the property by right of survivorship. To the extent that such transfer constitutes a completed gift to the ultimate beneficiaries at that time,[159] the survivor would be the transferor. Under this analysis, the property qualifies for the marital deduction in the estate of the first testator to die, but the surviving testator incurs gift tax liability upon the completed gift to the ultimate beneficiaries of a remainder interest in the property at the death of the first testator to die.[160]

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[157]See text accompanying note 37.

[158]Under section 2040(b) not more than half the fair market value of property held jointly by citizen spouses with right of survivorship is includible in the estate of the first spouse to die. Prior to 1981, the extent to which jointly held property was subject to the terms of a mutual will might have determined the portion of such property that was includible in the estate of the first testator to die because of the application of the consideration furnished test. See notes 29 and 84. If the mutual will severs the joint tenancy at its execution, only half the property would be includible in the estate of the first testator to die. If the joint tenancy remained intact until the death of the first joint tenant to die, then that portion as to which that tenant furnished the consideration would be includible in that tenant's estate.

[159]See text accompanying notes 38–101.

[160]See text accompanying notes 94–101.

On the other hand, if the property is received by the surviving testator subject to an obligation that became binding before the deceased testator died with the mutual will in effect, then the property will not qualify for the marital deduction in the estate of the first testator to die to the extent of the obligation.[161] If the obligation to transfer to others can be valued, and its value is less than the value of the deceased testator's share of the jointly held property, then the difference should qualify for the marital deduction.[162]

If jointly held assets are held to be received by the survivor outright by right of survivorship, and if the mutual will is not construed as imposing a binding obligation on the survivor to make a subsequent transfer, then the property will qualify for the marital deduction in the estate of the first testator to die,[163] as would any probate or nonprobate outright transfer. Such a finding implies that the mutual will directs disposition of the jointly held assets only as the will of the surviving testator and has no effect on the survivor's interest in the assets during life.

Resolution of these issues must occur on a case-by-case basis, through careful examination of the mutual will involved, and cannot be answered by mechanical recitation of the general rules governing title to jointly held property. Unfortunately, there likely will be many instances in which there is no reliable evidence of exactly what the mutual testators intended. In those cases, unless the applicable state law precludes such a finding, a federal court would be wise to follow the suggestion of the drafters of the Uniform Probate Code concerning the existence of a contract[164] by finding that the will is not contractual at all, but merely joint or reciprocal.[165] Such a finding would eliminate the need to determine whether restrictions govern the disposition of the jointly held assets. If the document is merely two wills in one with no contractual ramifications, or if the testators have reciprocal wills that are not contractual, then the surviving testator receives the jointly held property outright by right of survivorship. If the testators are spouses, then the portion that is includible under current law in the deceased testator's estate would qualify for the unlimited marital deduction. Any provisions in the testators' wills that deal with transfer of the property to other beneficiaries would be regarded as provisions of the will of the surviving testator alone and would neither disqualify the property for the marital deduction nor effect a completed inter vivos gift by the survivor.

Attorneys who continue to draft joint and mutual wills for married testators should carefully consider their clients' intent concerning the wills' application to nonprobate assets, particularly in light of several relatively recent changes in the

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[161] I.R.C. § 2056(b)(4).

[162] Treas. Reg. § 20.2056(b)-4(b).

[163] I.R.C. § 2056(c)(5).

[164] See U.P.C. § 2-701 and comment thereto.

[165] See, for example, Dekker v. United States, 245 F. Supp. 255 (S.D. IL 1965); Estate of Aquilino v. Commissioner, 31 T.C.M. (CCH) 906 (1972).

federal tax law.[166] Under current section 2040(b), not more than half of property that citizen spouses own jointly with right of survivorship is includible in the estate of the first spouse to die. However, all such property that passes to the survivor outright, and is includible in the estate of the first spouse to die, qualifies for the marital deduction, which is unlimited under current section 2056. Therefore, in an estate composed largely of nonprobate assets, any interpretation of a mutual will that finds that the jointly held property passed outright to the surviving spouse will result in no estate tax liability in the estate of the first spouse to die (although an overabundance of jointly held property may result in a loss of the benefit of that spouse's unified credit).[167] Conversely, any interpretation of a mutual will that finds a severance of the tenancy, either at the time of the execution of the mutual will or at the first testator's death, so that the deceased testator's half of the property passes in a way that does not qualify for the marital deduction, may result in estate tax liability in the deceased testator's estate, if that testator's other taxable assets are valuable enough to exceed the amount sheltered by the unified credit.[168]

Mutual Will Obligations as Debts of the Testators—Section 2053(c)

If a mutual will creates enforceable, reciprocal obligations in the testators to leave property to each other, the question arises whether the transfer of assets from the first to die to the survivor is a transfer in satisfaction of a debt and not a gratuitous transfer at all. If the obligation created by a mutual will is treated as a debt incurred for full and adequate consideration in money or money's worth, the fair market value of the obligation arguably would be deductible from the gross estate of the obligor under section 2053(a)(3).

Despite the superficial attractiveness of this argument, the obligation created by a mutual will should not be deductible. The first obstacle to deductibility is the time when the obligation under the mutual will becomes enforceable. In the vast majority of cases the testators do not intend the contract to be enforceable unilaterally while both testators are alive. Performance of the contract consists of one testator dying with the particular will in place. Therefore, the interest of the survivor is not deductible under section 2053 because, immediately before the death

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[166]The decision to maximize the benefit of the unlimited marital deduction and the unified credit is complex, and must be based upon a large number of tax and nontax considerations, most of which must be evaluated regardless of whether the clients will execute mutual wills. An extended discussion of these considerations is beyond the scope of this article. The purpose here is merely to alert the reader to the effect upon this decision of the consequences of particular interpretations of mutual wills.

[167]I.R.C. § 2010.

[168]Under section 2010, at current estate tax rates, the total amount that can be sheltered from estate or gift tax is $600,000 per taxpayer.

of the first testator to die, neither testator has any enforceable claim against the other.[169]

Second, and perhaps more importantly, section 2053(c)(1)(A) limits the deduction to those claims "contracted . . . for an adequate and full consideration in money or money's worth . . . ." Thus, because a promise to transfer property is not money or money's worth, a contract that is based on mutual promises does not generate an allowable deduction under section 2053, even though the contract is enforceable under state law.[170] Instead, the deduction is permissible only to the extent the obligor has received, or has an enforceable right to receive, property of equal value from the obligee. Deductibility is so limited to eliminate an obvious opportunity for estate tax avoidance: if nominal consideration were sufficient to sustain a deduction, taxpayers could circumvent the tax by simply contracting during life to make certain transfers at death.

At least one taxpayer has argued unsuccessfully in federal district court that property passing to a surviving mutual testator should be deductible from the estate of the first testator to die.[171] However, another court has stated in dicta that the transfer from one mutual testator to the other under a mutual will is supported by consideration.[172] The conclusion that a transfer under a mutual will from the first testator to die to the surviving testator is supported by adequate consideration may emanate from the following analysis: Immediately before the death of the first testator to die, the fair market value of the right of each testator to receive the other's assets under the mutual will presumably is capable of valuation. This expectancy is no different from any other present right to receive property of value in the future. The fact that each testator's receipt of any property under the mutual will is contingent upon surviving the other mutual testator affects the valuation of the interest but does not render it valueless; the likelihood that either testator will survive the other is determinable actuarially.[173] Approached from this perspec-

[169]Cf. Treas. Reg. § 20.2053–4 (". . . only [such claims] as represent personal obligations of the decedent existing at the time of his death [are deductible] . . ."); See also Lazar v. Commissioner, 58 T.C. 543 (1972) (amounts paid from estate in settlement of claims of nieces and nephew of decedent's deceased husband to portion of decedent's estate under alleged agreement between decedent and husband that decedent would leave the claimants certain property in her will in exchange for husband's having left certain property to her held not deductible under section 2053); Estate of May v. Commissioner, 8 T.C. 1099 (1947) (decedent's obligation as guarantor of another's note was not deductible as a "claim" against estate because, at the time of his death, it did not appear that he would be obligated to pay anything).

[170]Cf. Commissioner v. Copley's Estate, 194 F.2d 364 (7th Cir. 1952) (marriage and relinquishment of marital property rights, although sufficient consideration to render a contract enforceable under state law, are not full and adequate consideration for federal gift tax purposes.)

[171]Lindsey v. United States, 167 F. Supp. 136 (D. MD 1958).

[172]Estate of Jackson v. Commissioner, 88–1 U.S. Tax Cas.(CCH) ¶ 13,750 (N.D. TX 1987).

[173]The interest of the deceased testator in the property of the surviving testator probably is not includible in the deceased testator's estate because an interest that disappears by virtue of the decedent's death is not subject to tax under Code section 2033 and it is not an interest that is subject to inclusion under any other section. See, for example, Commissioner v. Rosser, 64 F.2d 631 (3d Cir. 1933); see also, R. Stephens, G. Maxfield, & S. Lind, Federal Estate and Gift Taxation § 4–101 (5th ed. 1983) ("it is necessary to look at Section 2033 property interests as of the moment after death").

tive, transfers under mutual wills might appear to resemble crossed or reciprocal transfers.[174] Such transfers might be treated as consideration for each other. If they were, the estate of the first mutual testator to die would include as an asset the fair market value of the property that the deceased testator would have been entitled to receive from the surviving testator if the order of deaths had been reversed. Meanwhile, the deceased testator's estate also would be entitled to a deduction for the fair market value of the deceased testator's property that the surviving testator is entitled to receive under the mutual will, which is what the deceased testator paid for the right to receive the survivor's property.

This analysis is inadequate to prevent estate tax inclusion for the deceased testator or to generate a deduction for his or her estate. The reciprocal transfer doctrine has been applied uniformly to prevent tax avoidance. To apply it in this instance would encourage tax avoidance. Moreover, the fact that the interest of each testator in the other's estate is capable of valuation does not mean that the interests are of equal value. Unless the value of what the predeceased testator received is equal to or greater than what that testator relinquished in executing the mutual will, the value of the surviving testator's interest in the deceased testator's estate cannot be a deductible claim under section 2053. To hold otherwise would be to encourage exactly the type of tax avoidance that section 2053(c) was designed to prevent: wealthy elderly taxpayers who were planning to leave substantial sums to less wealthy beneficiaries would enter into enforceable mutual wills with those beneficiaries when death was imminent so as to turn an otherwise taxable gratuitous transfer into a deductible debt.

In the case of transfers to third parties, the argument against deductibility is even more compelling. The deceased testator does not receive consideration in money or money's worth from the surviving testator for transfers under the deceased testator's mutual will, nor does the deceased testator receive any such consideration from any other beneficiaries. Therefore, allowing a deduction would reduce the deceased testator's estate while increasing the wealth of the beneficiaries, but no consideration in money or money's worth would have compensated the deceased testator for the shift of wealth. In this respect, to avoid tax free diminution of the deceased testator's estate, the obligation of the deceased testator to leave property to third parties cannot be considered a deductible debt within the meaning of section 2053(a).

In the closely related context of transfers pursuant to divorce settlement agreements, Congress enacted section 2043(b)(2) in 1984[175] to permit a section 2053 deduction from the estate of the deceased transferor. Moreover, inter vivos transfers made pursuant to such agreements are excluded from the gift tax base by section 2516. The justification for these provisions is that transfers pursuant to such agreements simply are not gifts.[176] Rather, they constitute the satisfaction of a

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[174]See United States v. Estate of Grace, 395 U.S. 316 (1969).

[175]Tax Reform Act of 1984, Pub. L. No. 98–369, § 425(a)(1), 98 Stat. 494, 803–884.

[176]See H.R. Rep. No. 1337, 83d Cong., 2d Sess., reprinted in 1954 U.S. Code Cong. & Admin. News 4017, 4467.

legal obligation similar to the payment of damages awarded in tort litigation. This characterization, and the consequent tax exemption, is justifiable with respect to transfers between spouses in the context of a divorce; clearly it should not be extended to cover voluntary transfers under a mutual will.

At the Death of the Surviving Testator

Transfers with Retained Interests

The immediately prior discussion focused on the effect of a mutual will on the characterization for transfer tax purposes of the surviving testator's interest in property formerly owned by the deceased testator. A mutual will also can affect the nature of the surviving testator's interest in his or her own property after the death of the first testator to die. The testators may have contracted that, in exchange for receiving certain interests in the deceased testator's property, the survivor would leave not only the property so received but also the survivor's property to certain beneficiaries. If that is the agreement between the testators, then the contract becomes executory as to the surviving testator when the first testator dies with the mutual will in place. As the prior analysis illustrated,[177] the surviving testator may have made a completed taxable gift to the ultimate beneficiaries of a future interest in any property owned by the survivor that is subject to such an agreement.

The fact that the surviving testator makes a taxable gift at the death of the first testator to die does not preclude inclusion of the transferred property in the survivor's gross estate for estate tax purposes. Ordinarily, the surviving testator will continue to enjoy rights in that property until death. To the extent the surviving testator continues to possess such an interest, inclusion of that property in the survivor's estate must be analyzed under sections 2035 through 2038, the provisions dealing with lifetime transfers in which the transferor retains an interest until death. Thus, for example, if the surviving testator under a mutual will makes a completed transfer of a remainder interest in his or her own property at the death of the deceased testator but retains a life interest in the property, that property will be includible in the survivor's estate under section 2036(a)(1).

Two courts that considered inclusion in the surviving testator's estate found that the survivor made a transfer of the survivor's own property at the death of the deceased testator and retained a sufficient interest to require inclusion in the survivor's gross estate at death.[178] Both opinions interpreted the mutual will as con-

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[177]See text accompanying notes 38–83.

[178]Olson v. Reisimer, 271 F.2d 623 (7th Cir. 1959); Scofield v. Bethea, 170 F.2d 934 (5th Cir. 1948) (decided under 1939 Code section 811(c)). See also Estate of Vardell v. Commissioner, 307 F.2d 688 (5th Cir. 1962) (surviving spouse's half of community property included in her estate under section 2036 when she elected, pursuant to the terms of her predeceased husband's will, to take a life interest in a trust that included all community property rather than retain her half outright). Furthermore, the court in Grimes v. Commissioner, 851 F.2d 1005 (7th Cir. 1988), discussed in text accom-

tractual and as creating in the survivor a life interest in the survivor's own property. Although the Tax Court's opinion in *Estate of Emerson v. Commissioner*[179] appears to reach a different result, the Tax Court never expressly stated in *Emerson* that the will was contractual. If the will was not a contract, the surviving testator did not make a completed transfer under it at the deceased testator's death because the transfer to the ultimate beneficiaries remained fully revocable until the survivor's death.

Olson v. Reisimer involved nonprobate assets[180] that the surviving mutual testator received by right of survivorship. The opinion dealt only with the inclusion of half of the property. Apparently the Commissioner was content to concede that the joint tenancy was severed at the death of the deceased joint tenant,[181] making the survivor the beneficiary of an interest under the will with respect to the half formerly owned by the deceased testator, and transferor with respect to only the other half. Because the will treated the asset as a single whole in providing for its disposition during the survivor's life and at the survivor's death, there was no reason to assume a severance was intended. The Service subsequently took the position that the nonprobate assets passed to the survivor outright when the first mutual testator died.[182] By virtue of having executed the mutual will, the survivor received the property subject to an obligation to transfer it by will to the remainder beneficiaries. Therefore, the Service concluded, the entire nonprobate property was includible in the survivor's estate under section 2036(a)(1).

The Service's analysis clearly is correct if no severance at the deceased testator's death is assumed, because the survivor must be regarded as receiving the entire asset by right of survivorship and as making a gift, which becomes complete upon the deceased testator's death, of the entire remainder following the survivor's life estate. Whether this is the correct analysis of the mutual testators' estate plan depends, however, upon the intent of the mutual testators. If they intended a severance, then the portion of the property deemed includible in the deceased testator's estate should not be included in the estate of the survivor, who received no more than a life estate in property that passes directly to the ultimate beneficiaries from the first testator to die. The remaining half of the property is not includible in the estate of the deceased testator but is includible in the estate of the survivor under section 2036(a)(1).

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panying notes 76–83, stated in dictum that the property of which decedent, the surviving testator of a mutual will, made a complete gift under the mutual will at the death of the first mutual testator to die also was includible in decedent's estate under section 2036 because he had retained a life estate in the transferred property. 851 F.2d at 1007.

[179]67 T.C. 612 (1977).

[180]271 F.2d 623 (7th Cir. 1959). The subject property in *Olson* had been held by the mutual testators as joint tenants with right of survivorship; Scofield v. Bethea, 170 F.2d. 939 (5th Cir. 1948), involved the surviving spouse's half of the married mutual testators' community property.

[181]The Commissioner argued in *Olson* for inclusion of only half the subject property, a position that was consistent with the private letter rulings at the time. See, for example, Priv. Ltr. Rul. 6402041580A (February 4, 1964).

[182]Rev. Rul. 71-51, 1971-1 C.B. 274.

With respect to both the survivor's separate assets and the survivor's half of jointly held assets, the question whether the survivor made a completed gift to the ultimate beneficiaries at the death of the deceased testator has a greater impact on the timing of the survivor's transfer tax liability than on the total transfer tax due. The survivor makes a taxable gift of a future interest to the extent (s)he makes a completed gift at the death of the deceased testator.[183] There is no gift tax liability if that gift is incomplete. On the other hand, the survivor will have estate tax exposure in either event. If the gift of the remainder interest is complete at the deceased testator's death but the survivor retains a life interest in the transferred assets, then the assets are includible in the survivor's estate under section 2036(a)(1) (with a credit against the estate tax due for the gift tax previously paid).[184] If the gift is incomplete at the deceased testator's death, then the assets are fully includible in the survivor's estate under section 2033. Therefore, the only difference in tax consequence will be whether part of the tax liability is payable earlier as a gift tax.

Mutual Will Obligations as Partial Consideration—Section 2043

Sections 2036 through 2038 do not reach transfers in which an interest was retained if the transfer was "a bona fide sale for an adequate and full consideration in money or money's worth."[185] The Code deals with transfers for partial consideration by providing, in section 2043(a), that any property transferred "for a consideration in money or money's worth, but [that] is not a bona fide sale for an adequate and full consideration in money or money's worth," is includible to the extent of the "excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent."

The issues raised by the existence of consideration are a bit more complex at the death of the survivor than those involved at the death of the first testator to die. The principal issue is whether the surviving testator received consideration from the deceased testator for making transfers of the survivor's property to third parties. An interest in the deceased testator's property that the deceased testator gave the survivor under the mutual will may be such consideration. For example, if spouses, each of whom had substantial individual assets, executed a mutual will in which they agreed that the first of them to die would leave all his or her assets to the survivor in return for the survivor's leaving all their collective assets to the couple's children, it could be argued that the survivor received a life interest in the deceased testator's property as consideration for leaving the children a remainder interest in the survivor's property. If this analysis is correct, then the value of the remainder interest in the survivor's own property otherwise includible in the survivor's estate under section 2036 should be reduced by the value of

[183]See text accompanying notes 38–124.
[184]I.R.C. § 2001(b)(2).
[185]Id. §§ 2036(a), 2037(a), 2038(a)(1), 2038(a)(2).

the interest received by the survivor from the deceased testator.[186] The court in *Olson v. Reisimer*[187] held that the survivor's interest in the deceased testator's estate is not consideration for the survivor's transfer to a third party in this context. Recently, another court, relying partly on *Olson*, held that relinquishment of an interest in community property is not consideration for receipt of an interest in other property under a will that required the beneficiary to renounce the community property interest before receiving the other property.[188] However, an earlier decision of a third court held to the contrary in an analogous case.[189]

Resolution of this issue presents a problem common to many aspects of transfer taxation because the transactions involved have both donative and nondonative characteristics. Although the testators of a mutual will contemplate an enforceable contract under which assets will change hands, to treat as consideration for transfers to others the property that one mutual testator receives from the other permits the nondonative characteristics to determine the transfer tax consequences to the exclusion of the donative characteristics. To so analyze the transactions under a mutual will invites widespread tax avoidance: testators would use mutual wills to pass property transfer tax free to those to whom the survivor would have made the same transfers without consideration.[190] In other words, the ultimate issue is whether the presence of an enforceable obligation

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[186]The formula described in section 2043(a) for allocation of partial consideration is itself the subject of some confusion because it appears to contemplate two different valuation dates: the consideration received by the decedent is to be valued as of the date of receipt but the asset that is potentially includible in the decedent's estate under sections 2035 through 2038 is to be valued as of the decedent's death. This discrepancy may result in a distorted determination of the net amount properly includible in the decedent's estate. Because these valuation questions do not affect interests transferred under mutual wills differently from interests transferred under other documents, they are not further discussed here. For a thorough treatment of them, see Dodge, Retention, Receipts, Transfers and Accumulations of Income and Income Rights: Ruminations on the Post-Byrum Role of Estate Tax Sections 2036, 2037, 2039 and 2043(a), 58 Tex. L. Rev. 1, 51–72 (1979) (hereafter cited as Dodge); Lowndes, Consideration and the Federal Estate and Gift Taxes: Transfers for Partial Consideration, Relinquishment of Marital Rights, Family Annuities, the Widow's Election and Reciprocal Trusts, 35 Geo. Wash. L. Rev. 50 (1966) (hereafter cited as Lowndes).

[187]271 F.2d 623 (7th Cir. 1959).

[188]Gradow v. United States, 11 Cl. Ct. 808 (1987), aff'd, 90–1 U.S. Tax Cas. (CCH) ¶ 60,010 (F. Cir. 1980).

[189]Estate of Vardell v. Commissioner, 307 F.2d 688 (5th Cir. 1962), involved the transfer tax consequences to a surviving spouse of having made an election, required by the will of her deceased spouse, to receive a life estate in all of the couple's community property, rather than to retain her own half outright but to receive no interest in her husband's half. The Court of Appeals for the Fifth Circuit held that the surviving spouse's half of the community property was includible in her gross estate under section 2036(a)(1) but that the transfer of the remainder of her half of the community property was supported by full and adequate consideration to the extent in her life estate in her husband's half; therefore, the amount includible in the surviving spouse's estate was subject to reduction under section 2043. The Court of Appeals remanded to the Tax Court for valuation of the amount includible in the surviving spouse's estate.

[190]Professor Lowndes advocated a similar analysis of transfers made pursuant to a surviving spouse's election. Lowndes at 68–71 (cited in note 186). But see Dodge at 51–77 (cited in note 186) outlining a number of possible approaches to determine whether related transfers can be partial consideration for one another under sections 2036(a) and 2043.

supported by consideration to leave property to certain beneficiaries renders the transfers nongratuitous and, therefore, excludible from the transfer tax base, although the transferor would have made the same transfer without consideration. Determining what the transferor would have done had there been no consideration obviously is a matter of subjective intent, further complicated in this case by the fact that the transferor is dead. The integrity of the transfer tax system requires that all transfers to the natural objects of the transferor's bounty be treated as gratuitous transfers, fully subject to transfer taxation, and not as transfers for partial consideration, unless the taxpayer can prove that the mutual testators would not have made the transfers to third parties had they not received consideration for them from each other.[191]

Section 2053 (reprise)—Deductibility of the Ultimate Beneficiaries' Interests in the Surviving Testator's Property

The Service takes the position that the interests of the ultimate beneficiaries under a mutual will are not deductible claims against the estate of the surviving testator under section 2053(a), the general section dealing with deductibility of claims against the estate.[192] Section 2053(c) also limits the deduction to those claims that the decedent "contracted bona fide and for a full and adequate consideration in money or money's worth."[193] Although there have been no cases on this precise issue, the court in *Bank of New York v. United States*[194] considered the closely related question of adequacy of consideration under section 2053(c) for amounts paid to third parties in settlement of a state court action for breach of contract brought against the estate of one of the testators of a mutual will. To prevent transfer tax avoidance through bogus litigation, such settlement payments, as well as payments in satisfaction of a judgment when such actions are litigated, must be treated in the same manner as the underlying claims. Therefore, pay-

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[191]A similar problem occurs if property is transferred under a divorce property settlement and the transferor-spouse retains an interest in the transferred property. In that context, the courts have held that the remainder interest transferred by one spouse to third parties, often the couple's children, may be treated as transferred for consideration under section 2043 to the extent it is transferred in satisfaction of the other spouse's support rights. See, for example, Estate of Glen v. Commissioner, 45 T.C. 323 (1966). The rationale for this result is that the nontransferor-spouse, by giving up the right to receive property to which that spouse is entitled, paid the other spouse to transfer property to the third parties. This result implies that the spouse who relinquishes those rights makes a gift to the ultimate beneficiaries. Cf. Rev. Rul. 77- 314, 1977-2 C.B. 349 (spouse who bargains specifically for such transfers to third parties is donor thereof; spouse who merely relinquishes rights without bargaining specifically for transfer to others is not donor). Although there surely are transferor-spouses who would not have made the transfer but for the other spouse's relinquishment of a claim, there also must be transferor-spouses who would have made the transfer in any event because they wished to benefit the third parties. Thus, in the divorce context, the law permits the spouses some room to negotiate for the transfer tax liability. This result is justifiable given the fact that the difficulty and cost of determining true donative intent in this context outweigh the additional tax likely to be collected.

[192]Priv. Ltr. Rul. 7910004 (August 31, 1978).

[193]See text accompanying notes 169–176.

[194]526 F.2d 1012 (3d Cir. 1975). See also Luce v. United States, 444 F. Supp. 347 (W.D. MO 1977).

ments in settlement of an action for breaching the contractual obligations of a mutual will are deductible claims under section 2053(a) only to the extent that transfers in compliance with those obligations would be.

In *Bank of New York*, subsequent to the death of the first testator to die, the survivor executed a new will that was inconsistent with the allegedly contractual mutual will. The state court suit was settled and the executor of the estate of the survivor deducted the amounts paid to the plaintiffs in the contract action on the ground that the plaintiffs' claim had been contracted for full and adequate consideration by the decedent with the deceased testator. The court denied the deduction, holding that the agreement between the testators, who were spouses, did not meet the standard of section 2053(c)(1)(A).[195] Neither party relinquished anything in money or money's worth to the other for the purpose of inducing the recipient to execute the mutual will. Rather, the mutual will evidenced the testators' common desire to make gifts of their assets to certain beneficiaries after the death of both testators. They chose the mutual will approach to render their decision irrevocable.

The result in *Bank of New York* clearly is correct. The amounts transferred in settlement of the legatees' claim are no different from the amounts transferred in settlement of a will contest. Both are claims to entitlement to a gratuitous transfer, and not to a contract right supported by full and adequate consideration.[196]

General Powers of Appointment Over the Deceased Testator's Assets

If the surviving mutual testator receives the power to dispose of assets that belonged to the first testator to die but does not receive outright ownership of those assets, the question arises whether the survivor possesses a general power of appointment over the assets sufficient to require their inclusion in the survivor's estate under Code section 2041. A general power of appointment is defined by section 2041(b)(1) as exercisable by the powerholder "in favor of [himself], his estate, his creditors, or the creditors of his estate." Because the statute is disjunctive, a power merely to consume the property is a general power of appointment,[197] as is a power exercisable in favor of only one of the enumerated appoint-

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[195]526 F.2d at 1016.

[196]The executors in *Bank of New York* made an alternative argument on appeal, which the court refused to consider because it had not been made in the district court. They argued that the amounts paid to settle the contract litigation should be excluded from the estate of the surviving testator. Id. at 1019. The section 2053 issue can arise only if the property subject to the claim is includible in the estate claiming the deduction. The opinion notes that both testators had substantial estates. Id. at 1013. The surviving testator may have received no more than a life estate in the deceased testator's separate property, because the remainder passed to the ultimate beneficiaries directly from the decedent at death. A life estate would not render the property includible in the survivor's estate, in which case the issue under section 2053(c) would not arise. The language of the wills is not reproduced in the opinion, so it is impossible to determine the nature of the survivor's interest.

[197]Treas. Reg. § 20.2041-1(b).

ees.[198] However, section 2041(b)(1)(A) expressly provides that a power is not general if it is a power to consume that is subject to "an ascertainable standard relating to the [powerholder's] health, education, support or maintenance . . . ."

Mutual wills often give the surviving testator a life interest in the deceased testator's assets, together with power to dispose of the principal, often phrased in general terms as a power to sell the assets or to use them for the survivor's benefit. Whether this interest constitutes a general power of appointment depends on the intent of the testators concerning the scope of the power. If the testators are found to have intended that the survivor have unlimited power to consume the property during life subject only to the requirement that whatever remains be left to the named beneficiaries at the survivor's death, then the survivor possesses a general power of appointment and the deceased testator's assets should be includible in the survivor's estate. If, on the other hand, the survivor is granted only a very limited power to consume for the purposes stated in section 2041(b)(1)(A), then the power is nongeneral and the deceased testator's property should not be includible in the survivor's estate.

In the case of married mutual testators a similar, but not identical, question arises concerning the availability of the marital deduction in the estate of the first testator to die. A number of courts have held that the surviving testator's power is not sufficiently broad to qualify the subject property for the marital deduction. Interestingly, courts that considered the question in the context of section 2041 have uniformly held that the survivor possesses a sufficiently broad power to require inclusion in the survivor's estate, despite the fact that the language of the wills in the two sets of cases is quite similar.[199] Unfortunately, this difference means that property bequeathed to a surviving spouse under a mutual will does not qualify for the marital deduction in the estate of the deceased spouse, but is includible in the estate of the survivor under section 2041.

The different results are not due to an incorrect judicial interpretation of either the Code provisions or the language of the mutual wills under scrutiny. Rather, they are caused by the difference in the scope of the two statutes and the fact that the intent of the testators is likely to fall exactly where that scope differs. Under section 2041, the powerholder need only have power to consume. Under

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[198]See, for example, Estate of Edelman v. Commissioner, 38 T.C. 972 (1962) (power exercisable only in favor of the powerholder's estate is a section 2041 power); Priv. Ltr. Rul. 8836023 (September 12, 1988) (power exercisable only in favor of the powerholder's creditors is a section 2041 power).

[199]See, for example, Phinney v. Kay, 275 F.2d 776 (5th Cir. 1960) ("the survivor . . . shall . . . have all of the estate . . . to be used, occupied, enjoyed, conveyed and expended . . . as such survivor shall desire . . . and that upon the death of such survivor any of such estate then remaining shall be divided among the persons following . . .); Potter v. United States, 269 F. Supp. 545 (N.D. WV 1967) ("the survivor shall . . . use said property for and during his or her lifetime, with full right to use, utilize, and dispose of the same, including the right to sell . . . . Upon the death of the survivor . . . all of our property shall go . . . to our . . . children . . ."). See also Estate of Beyer v. Commissioner, 33 T.C.M. (CCH) 111 (1974), holding that the following language creates a general power of appointment in the survivor, but not explicitly holding that the will is mutual: ". . . all such property . . . of the one so dying first . . . is hereby given . . . to the survivor, upon condition, however, that whatever so remains of the same after the death of the survivor, is given . . . as hereinafter set forth . . . ."

section 2056(b)(5), the powerholder must be able to exercise the power "alone and in all events," and the regulations have interpreted this language to require that the powerholder have the power to make gifts of the property to others.[200] Those who execute mutual wills most likely intend to give the survivor maximum flexibility to use the family assets for the survivor's personal benefit during life, but to bind each other contractually to transfer to particular beneficiaries all assets remaining at the survivor's death, no matter which of the testators owned each asset originally. In other words, they intend the survivor to have an unlimited power to consume, but no power to make inter vivos gifts (except, perhaps, to those who will receive the property under the will after the survivor's death).

The difference in the scope of sections 2041 and 2056(b)(5) is an unnecessary trap for the unwary that potentially affects all married testators, not only those who execute mutual wills. Section 2056(b)(5) should be amended so that a general power of appointment that renders the subject property includible in the surviving spouse's estate under section 2041 also qualifies the property for the marital deduction.[201] Until such a legislative change is made, testators who insist upon binding each other contractually to leave their separate estates to particular individuals will be forced to choose among foregoing the marital deduction in the estate of the first spouse to die, using a QTIP marital deduction trust in the deceased testator's estate, and having the property of the surviving testator pass separately at the survivor's death. A complete analysis of the advantages and disadvantages of the different types of marital deduction clauses is beyond the scope of this article. Use of the QTIP marital deduction may be unattractive to testators who have chosen to use mutual wills to effectuate their estate plans because it requires them to choose between using more complex provisions for the disposition of their estates or incurring the additional expense and loss of flexibility inherent in permitting the assets of each testator to pass separately rather than consolidating them at the death of the first testator to die.

PLANNING CONSIDERATIONS

The practitioner should discourage the use of mutual wills for two reasons. First, use of a mutual will rarely is the simplest way of fulfilling a client's estate planning goals. Second, use of a mutual will increases the difficulties of assuring predictable transfer tax results. Therefore, the practitioner should strongly encourage use of individual wills or living trust instruments to achieve clients' goals.

The most common reasons clients give for using a mutual will is that they are cheaper to prepare and simpler to implement because they involve only one document, and that they permit the testators to bind each other to a particular estate plan. The practitioner quickly can dispel the notion that mutual wills are cheaper to prepare, and this article provides adequate evidence of the difficulties of im-

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[200]Treas. Reg. § 20.2056(b)–5(g)(3).

[201]See text accompanying notes 142–143.

plementing an estate plan embodied in a mutual will. Such wills present difficult questions under federal wealth transfer tax law and under state property and contracts law as well.

Mutual wills permit testators to bind each other to a particular estate plan. However, the desired control over the ultimate disposition of assets often can be achieved using an individual will containing properly drafted trust provisions or an irrevocable lifetime trust. Furthermore, the practitioner must be certain that clients understand and wish to bind each other to the extent that they likely will be bound by a mutual will.[202] Practitioners would do well to question clients closely about the property of which they wish to make a binding disposition, and why, so they can suggest appropriate alternatives to a mutual will.

For example, a client who wishes to provide support and financial flexibility for a surviving spouse while determining the ultimate disposition of the client's own property can achieve these goals by executing an individual will containing a trust for the spouse for life, and directing disposition of the remainder in the desired manner. If estate tax minimization also is a goal, and the practitioner wishes to assure that the trust will qualify for the estate tax marital deduction, the trust should be drafted so that it qualifies for the QTIP election.[203] Clients who wish to bind each other to leave their property in a certain manner may be advised concerning creation of an irrevocable lifetime trust of their assets. Clients also must be warned that an irrevocable trust is a dangerous vehicle to use for this purpose for the same reason that it is attractive: it precludes the grantors from changing the disposition of their assets while both are still alive.

If a client is adamant about using a mutual will, or insists upon an estate plan that requires another (for example, a spouse) to make a binding promise concerning the post-death disposition of the spouse's own assets, while insisting on complete lifetime freedom to change disposition of his or her own assets, the practitioner may be forced to draft a mutual will. If so, the practitioner would be well advised to include in the will the parties' intent concerning the scope of the contract, the exact nature of the interests transferred, and the intended consequences. For example, if the parties own survivorship property, the will should state whether the parties intend the will to control these assets and, if so, whether they intend the tenancy to be severed at execution of the will, at the death of the first testator to die, or not at all. Similarly, if the mutual will grants the surviving testator interests in the property of both testators after the death of the first testator to die and provides for their total assets to pass to others at the survivor's death, the mutual will should state whether the parties intend the survivor to own the predeceased testator's property outright, or to have a life interest and a power of consumption, and if the survivor's interest is less than outright ownership, the exact scope of the survivor's power to consume the property. If the mutual testators are spouses, the practitioner should advise them of the different consequences of different powers of consumption under the estate tax marital deduc-

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[202]See, for example, Estate of Grimes v. Commissioner, 56 T.C.M. (CCH) 890 (1988).
[203]I.R.C. § 2056(b)(7).

tion.[204] Furthermore, the mutual will should state clearly whether the survivor's obligation to transfer the survivor's own property to the ultimate beneficiaries becomes irrevocable at the death of the first testator to die. The practitioner should advise the testators that binding the survivor to the estate plan set out in the will at the death of the first testator may have adverse gift tax consequences[205] and severely limits the survivor's ability to deal with changed health, financial, or other circumstances arising after the death of the first testator to die. Lastly, the practitioner must advise the testators that, even if the will contains a detailed statement of their intent, it still may be interpreted by a court in a way that frustrates that intent.[206]

CONCLUSION

Ascertaining the proper federal wealth transfer taxation of transfers pursuant to a mutual will presents a number of challenging questions, primarily because of the complexity of the relationships created by the document itself. A truly mutual will is both a contract and a will. Thus, it has the attributes of two types of documents that ordinarily are employed to do quite different things. A contract embodies a binding bilateral agreement to do certain things. In the case of a contractual will, the agreement ordinarily concerns transfer of property rights. A will sets out an individual's desires concerning the final disposition of his or her property after death. A contract is not unilaterally revocable. A will is a unilateral document that has no effect until the testator dies; therefore, it is revocable at any time during the testator's life. Interpretation of contracts and wills, and the rights and duties created by each, are subjects of discreet bodies of state law.

To determine the proper wealth transfer taxation of any gratuitous transfer, it is necessary first to determine the nature of the property rights transferred. A basic tenet of federal wealth transfer taxation is that these property rights are determined under applicable state law first, and the federal tax law then is applied to the rights thus found.[207] Because of the complexity and number of the possible relationships that can be created under state law by execution of a document such as a mutual will, determining the proper transfer taxation of bequests made

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[204]See text accompanying notes 125–168.

[205]See text accompanying notes 38–101.

[206]See, for example, Estate of Stewart v. Commissioner, 79 T.C. 1046 (1982) (mutual will stating that "upon the death of either of [the testators, any] . . . tenancy [by the entirety in which the testators are involved] shall be dissolved" was treated as severing tenancy by the entirety at time of execution of will, rather than at death), discussed at text accompanying notes 21–26; Estate of Lidbury v. Commissioner, 800 F.2d 649 (7th Cir. 1986) (mutual will requiring surviving testator to use the testators' assets "so as not to dissipate any of said property" and prohibiting the survivor from "in any manner directly or indirectly dispos[ing] of his or her property to the end that the general plan of distribution, as provided herein, shall be altered and changed in any form whatsoever" held not to impose any quantifiable limit on the survivor's power to consume the testators' property), discussed in text accompanying notes 73-75.

[207]See, for example, S. Surrey, W. Warren, and H. Gutman, Federal Wealth Transfer Taxation 71 (successor ed. 1987).

under mutual wills is necessarily difficult even for those who are well versed in the general pattern of federal wealth transfer taxation of gratuitous transfers of property rights. The determination is further complicated by the need to ascertain whether a particular joint will really is contractual, rather than merely joint or reciprocal, and then to separate the portions of the document that are intended to embody the contract from those that are the will of one of the testators. This determination requires an inquiry into the intent of the parties, who frequently are dead when the inquiry is made, and who often have left insufficient reliable evidence of their intent, or evidence indicating that they did not develop their intent fully at the time they executed the document. Nevertheless, federal courts sitting to determine the federal transfer tax consequences under mutual wills must make these preliminary determinations if they are to achieve a rational system of taxing the transfers made by such wills.

The most critical of these preliminary inquiries is whether the will is contractual. If it is not, the transfer tax consequences of transfers made pursuant to the will are no different from those of transfers made pursuant to ordinary wills. Therefore, a court sitting to determine the federal wealth transfer tax consequences of such a non-contractual joint will must construe it as two individual wills, and must ascertain the transfer tax consequences of each will as though the testators had communicated their wishes concerning the disposition of their assets in two separate documents.

On the other hand, if the court determines that the will is contractual, perhaps the court must next undertake the task of separating the contractual aspects of the will from the donative aspects, and determining the scope of the contractual obligations. In making these determinations the federal courts must remember that their ultimate task is to determine tax liability based upon the extent to which property rights are transferred under state law. Therefore, they must ascertain the rights created by the document as it would be interpreted under applicable state law. In this quest, the court should pay careful attention to any indication of the testators' intent, and must be careful to avoid making distinctions that are based on the state law labels for the relationships created, rather than on the property rights that emanate from those relationships. For example, the federal gift tax applies only to complete transfers in which the transferor relinquishes control over subsequent disposition of the transferred property.[208] Under general principles of the law of decedents' estates, a will is revocable until the death of the testator.[209] Ordinarily a transfer that is "revocable" under state property law is incomplete for federal wealth transfer tax purposes.[210] However, the rule governing revocability of wills is irrelevant to a determination of whether a mutual testator made a complete transfer, subject to gift tax at some time prior to death, by virtue of the contractual provisions of the mutual will. Although the testator can revoke a will unilaterally, the obligor under a contract cannot. On the other hand,

[208]Treas. Reg. § 25.2511-2(b) through -2(d).
[209]T. Atkinson, The Law of Wills § 84 (2d ed. 1953).
[210]Treas. Reg. § 25.2511-2(c).

parties to a mutual will may have intended to permit the survivor unlimited control of the testators' assets after the death of the first testator to die, subject only to the requirement that the survivor leave whatever is left of the property to certain beneficiaries at death. There is no reason that such an estate plan cannot be embodied in a mutual will. Similarly, assets that are titled jointly with right of survivorship are referred to as "nonprobate assets" under general principles of decedents' estates law. That is, the survivor receives the property by virtue of the terms of the deed, regardless of the terms of the predeceased testator's will.[211] Ordinarily, because such nonprobate assets pass outright to the survivor under the deed, they qualify for the federal estate tax marital deduction when they pass to a deceased joint tenant's surviving spouse.[212] Again, however, labelling the property as a nonprobate asset under state property law may be irrelevant to a determination of whether the asset qualifies for the marital deduction, if the mutual will, functioning as a contract between the testators, subjects the survivor to a prior binding obligation to transfer the property to others at death.

In ascertaining whether the provisions that govern the transfers to be taxed are contractual, federal courts must be sensitive to the fact that testators request "joint and mutual wills" because they believe them to be simpler and cheaper, rather than because they intend to bind each other contractually to a particular estate plan. In other words, they ask for a joint and mutual will, but really desire a joint will, and may never be advised as to the difference. Therefore, the courts should be extremely wary of finding a contract, absent a clear indication in the document that the testators intended the document to be contractual and, even when the testators have indicated such an intent, should be equally wary of finding that the survivor's interest in the testators' assets is limited by an obligation to transfer a specific portion, as distinct from whatever is left over, to named beneficiaries at death.

Courts also should be sensitive to the opportunities for tax avoidance that will occur if the contractual nature of a transaction operates to relieve the transferor of tax liability. For example, if one transfer pursuant to a mutual will is treated as consideration for estate tax purposes for another transfer under the will, wealthy testators will have considerable incentive to execute mutual wills to reduce the estate tax that otherwise would be due on transfers that they would have made anyway under an individual will.

Once the donative and contractual aspects of a mutual will are separated properly, and the scope and timing of the performance of the contractual obligations is ascertained, a determination of the federal estate and gift tax consequences of the transfers made by the mutual will requires application of the same principles as does such a determination generally. The challenge, then, to a federal court sitting to determine the federal transfer tax consequence of transfers pursuant to a mutual will is to analyze accurately the nature and timing of the property interests transferred.

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[211] 4 J. Thompson, Real Property § 1776 (1979 and Supp. 1981).

[212] I.R.C. § 2056(c)(5).