T.C. Memo. 1972-173

Property passing to a surviving spouse under a joint will, which contractually binds the spouse to devise the remaining property to children, constitutes a terminable interest and does not qualify for the marital deduction under Section 2056 of the Internal Revenue Code.

Summary

Saul and Ida Krampf executed a joint will stipulating that upon the death of either, all property would pass to the survivor, and upon the survivor's death, to their children. After Saul's death, his estate claimed a marital deduction for the property passing to Ida. The Tax Court denied the deduction, reasoning that the joint will created a binding contract. This contract obligated Ida to devise any remaining property to their children, thus creating a terminable interest that does not qualify for the marital deduction under Section 2056. The court also upheld a penalty for the estate's failure to file the estate tax return on time.

Facts

Saul and Ida Krampf, husband and wife, executed a joint will on November 19, 1958. The will contained two key provisions: First, upon the death of either spouse, all property of the deceased would pass to the surviving spouse. Second, upon the death of the surviving spouse, all remaining property would pass to their two daughters. At the time of the will's execution and at Saul's death, both spouses held separate interests in real and personal property. Saul Krampf died on July 5, 1965, a resident of New Jersey. His estate filed the federal estate tax return late and claimed a marital deduction for the property passing to his wife, Ida, under the joint will.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the federal estate tax and imposed an addition to tax for late filing. The Estate of Saul Krampf, with Ida Krampf as executrix, petitioned the Tax Court for review of these determinations.

Issue(s)

1. Whether the interest in property passing to Ida Krampf under the joint will qualifies for the marital deduction under Section 2056 of the Internal Revenue Code.

2. Whether the petitioner is liable for an addition to tax under Section 6651(a) for failing to file the estate tax return on time.

Holding

1. No, because under New Jersey law, the joint will constituted a binding contract

that created a terminable interest in the property passing to Ida Krampf, which does not qualify for the marital deduction.

2. Yes, because the petitioner failed to demonstrate that the late filing was due to reasonable cause.

Court's Reasoning

The Tax Court applied New Jersey law to determine the nature of the property interest created by the joint will. The court cited New Jersey precedent establishing that a joint will constitutes a contract between the testators to dispose of their estates jointly, with the survivor bound to perform the contract. The court found that the Krampf's joint will was indeed contractual, particularly paragraph Third, which clearly expressed a mutual desire for the ultimate disposition of their property to their children. Consideration for this contract was found in the mutual inducement to create a joint estate plan. As both spouses possessed separate property, the consideration was deemed adequate.

Because of this contractual obligation, Ida Krampf was bound to devise any unconsumed property received from Saul to their children. The court reasoned that the children became third-party beneficiaries with enforceable rights against Ida's estate, preventing her from altering the testamentary disposition through a new will or inter vivos gifts intended to circumvent the contract.

The court then applied Section 2056(b)(1), which disallows a marital deduction for terminable interests. A terminable interest exists if there is a possibility that the surviving spouse's interest may terminate and that another person may possess or enjoy the property after termination, where that interest passed from the decedent to that person other than for adequate consideration. The court concluded that Ida Krampf's interest was terminable because, upon her death, the children, as beneficiaries of the joint will contract, would possess and enjoy the unconsumed property. Their interest passed from Saul at or before his death without adequate consideration. Therefore, the marital deduction was disallowed.

Regarding the addition to tax, the court noted the estate filed the return 12 days late and presented no evidence of reasonable cause for the delay, thus failing to meet its burden of proof. The penalty for late filing was upheld.

Practical Implications

Krampf v. Commissioner underscores the estate tax implications of joint wills, particularly concerning the marital deduction. It clarifies that while a joint will may provide for a surviving spouse, if it contractually binds that spouse to dispose of the remaining property in a predetermined manner (e.g., to children), the interest passing to the spouse may be deemed a terminable interest. This case serves as a critical precedent, especially in jurisdictions where joint wills are interpreted as contracts. Legal practitioners must carefully consider the interplay between state contract law and federal estate tax law when advising clients on estate planning involving joint wills. This decision highlights the necessity of exploring alternative estate planning tools, such as trusts or separate wills with similar but non-binding testamentary desires, to achieve both spousal support and potential marital deduction benefits while ensuring desired ultimate beneficiaries are provided for. Subsequent cases will likely rely on *Krampf* to deny marital deductions in similar situations involving joint wills that impose contractual obligations on surviving spouses regarding property disposition.

