Regulating Survivorship Agreements and Other Will Substitutes

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I. INTRODUCTION

A. History, Basic Concepts and Terminologies

"The earth belongs in usufruct to the living; the dead have neither powers nor rights over it. The portion occupied by any individual ceases to be his when he himself ceases to be, and reverts to society."[1] Although the traditional view of estate planning involves a will of some kind, a majority of people do not have wills. This not only indicates a fear of death and dying, but also reflects the more general problem of the public's hesitation to consult an attorney, as well as the cost and effort of making a will. Furthermore, the costs and aggravations of probate are ever-present issues for many propertied individuals.

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1. Thomas Jefferson's words resound throughout the ears of each person faced with devising and bequeathing property.

Every person who dies in this country has the power to dispose of his or her properties to a designated party. Probate is the system which facilitates the disposition of properties at death. Under the Rules of Court, a probate court concerns itself primarily with the administration of estates, regardless of the existence or non-existence of the decedent's will and whether it consists of millions of pesos or a paltry sum. The probate court either executes the decedent's will or distributes the decedent's property through the intestacy system. The probate system, however, which was originally designed to protect recipients and implement the intent of the decedent, has become a confusing and frustrating process. The costs of probate, the often lengthy delay in distribution of property, the publicity, the makeup, and the system in general, create a growing impetus for *avoiding* probate. This aversion for probate is most evident in the United States; and the fact that it is a common law jurisdiction made up of 50 smaller jurisdictions complicates further the issue of what are *non-probate assets* or *non-testamentary dispositions.*

In 1969, the American Bar Association (ABA) and the National Conference of Commissioners on Uniform State Law attempted to reform and simplify the probate system when they created the UPC or the Uniform Probate Code.[2] In relation to this, Professor Langbein, a leading scholar and commentator on trust and estate law, has stated that the intensity of hostility toward probate may have abated somewhat in the few jurisdictions which have adopted the UPC, but despite the attempts to reform probate, such efforts will always be constrained, at least in part, by the intrinsic limits of probate. Langbein has noted that

> [b]ecause the Anglo-American procedural tradition is preoccupied with adversarial and litigational values, the decision to organize any function as a judicial proceeding is inconsistent with the interests that ordinary people regard as paramount when they think about the transmission of their property at death: dispatch, simplicity, inexpensiveness, privacy. As long as probate reform still calls for probate, it will not go far enough for the tastes of many transferors, who view probate as little more than a tax imposed for the benefit of court functionaries and lawyers.[3]

There is no need to go as far as Langbein's call for probate abolition. Undoubtedly, the probate system in the Philippines, though leaving a lot to be desired, has some value in the system of succession. On the other hand, the non-probate system, despite its apparent popularity, brings with it an array of problems.

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2. Grayson M.P. McCouch, *Will Substitutes Under the Revised Uniform Probate Code*, 58 BROOK. L. REV. 1123, 1130-31 (1993).

3. John H. Langbein, *The Non-probate Revolution and the Future of the Law of Succession*, 97 HARV. L. REV. 1108, 1116 (1984).

There has been a definite lack of unity among the states in the United States with regard to non-probate transfers. Today, the diverse treatment of heirs and creditors with respect to non-probate transfers present problems for courts not only in the United States, but also in the Philippines, where there is an increasing use of non-probate transfers.

The distinction between testamentary and non-testamentary dispositions has generated much doctrinal confusion and uncertainty. This confusion is further aggravated by the different terms used by the courts in the United States. Various terms, such as *will substitutes*, *non-testamentary dispositions*, *non-probate assets* and *non-probate transfers*, have been used in reference to these transactions. For the purpose of this Article, however, these terms shall be used interchangeably to refer to

> dispositions of property created by a property owner in favor of others by contract, deed, trust or gift in such a way that the same ultimate distribution of the estate that could have been made by will is achieved but are not governed by the laws on succession and need not pass through probate.[4]

In the place of testamentary dispositions and intestate administration, non-probate transfers of property have become a realistic and practical alternative to the probate system. Since the 1960's, when Norman Dacey's book *How to Avoid Probate* was a bestseller, institutions such as banks, investment companies and life insurance companies that promote the transfer of wealth outside probate were bestsellers as well. This is because non-probate transfers are a preferable alternative to the probate system for people who simply do not want, or believe that they cannot afford to hire an attorney to draft a will.[5]

Eminent legal jurists in the United States consider Norman Dacey as the father of modern non-probate transfers; *modern* because while contracts such as insurance contracts, joint bank accounts, revocable trusts, and joint tenancy relations have been around for a long time, it was Dacey's *How to Avoid Probate* that showed people how to set up their own living trusts without the need of a lawyer. The book featured tear-out pages with fill-in-the-blank living trust forms that the do-it-yourself estate planner could use to make himself the settlor of his own living trust, to name himself the trustee of the trust, and also to be the beneficiary of the trust during his lifetime. At death, the living trust would distribute his or her estate to the chosen beneficiaries, without lawyers or court involvement. This distinction

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4. JOHN RITCHIE, ET. AL., DECEDENT'S ESTATE AND TRUSTS 724 (1988).

5. NORMAN DACEY, HOW TO AVOID PROBATE (1965). He recently wrote an updated version published in 1993.

given to Dacey is quite a feat considering he is not a lawyer,[6] as his book's main thrust is the non-necessity of the lawyer.

Norman Dacey's "Do It Yourself Kit," to the disdain of the ABA, led the way for the proliferation of *will substitutes*, in general, and particularly of *living trusts*. Their popularity grew in the 1980's, as it was not unusual to see newspaper advertisements promoting financial and estate planning seminars that showed how to save taxes, avoid attorney fees and probate expenses, and arrange financial affairs to make the administration of one's estate efficient, inexpensive, and private.[7]

B. Types of Will Substitutes

An alternative to the disposition of one's assets by *will* is the disposition of property through the use of *will substitutes*. Will substitutes are documents which purportedly accomplish what a will is designed to accomplish, which is to declare how an individual intends to dispose of his property when he dies. Until fairly recently, United States courts did not validate will substitutes because the law permitted property to pass upon the testator's death only through intestate succession or through a validly executed will. However, today, every state in the United States recognizes the inherent validity of will substitutes as a means to dispose of assets at death. While there are many different types of will substitutes, they all share a common legal characteristic: the assets disposed of through a will substitute do not become part of the testator's probate estate. Such legal characteristic, however, is not entirely true in the Philippines as of yet, though some types have been validated by the Supreme Court. For the most part, they have yet to be tested before the Philippine legal system.

Concededly, will substitutes benefit both the beneficiaries and the testator or decedent, which is the more apt term. Will substitutes simplify the disposition of the decedent's estate by allowing him or her to avoid the formalities of will execution required by the laws on succession. Will substitutes also enable beneficiaries to avoid the delays and costs of probate and protect the assets from creditor claims. Finally, the use of will substitutes

6. *See In the Matter of* New York County Lawyers' Association v. Norman F. Dacey, 283 N.Y.S.2d 984, 28 A.D.2d 161 (1967) (Dacey was charged with the *unauthorized practice of law* but was later exonerated by the New York Court. The reasoning was that an essential element of the practice of law is the representation and advising of a particular person in a particular situation. Since Dacey's book was for the general public, and not intended to advise a particular individual, Dacey's activity therefore was not unauthorized practice of law.).

7. Dennis M. Patrick, *Living Trusts: Snake Oil or Better than Sliced Bread?*, 27 WM. MITCHELL L. REV. 1083, 1084 (2000).

avoids delays in beneficiaries' receipt of title and possession of the property. While the disposition of probate assets can entail a complicated process taking up to 20 years in extreme cases, beneficiaries generally receive non-probate property shortly after the decedent's death, as in the case of joint bank accounts. Whereas under the Philippine system of probate, it is not surprising to see cases where the intended beneficiaries no longer receive the property themselves but their respective heirs, for they too, like the decedent, have long passed.

Black's Law Dictionary provides a substantially complete list of will substitutes as follows:

> (1) joint tenancies either in real or personal property, (2) tenancies by the entireties, (3) homestead rights and exemptions, (4) partnership survivorship agreements, (5) joint bank accounts with provisions for survivorship, (6) government savings bonds payable to alternative payees, (7) government savings bonds payable to a named person and upon his death to a named survivor, (8) bank account trusts, commonly known as Totten trusts after the first case that gave them recognition, (9) regular *inter vivos* trusts with powers, including that of revocation, reserved, (10) deeds creating future interests, such as an executory interest to take effect at the grantor's death or creating a remainder in the grantee with a life estate reserved in the grantor, (11) deeds unconditionally delivered to an escrow to be delivered to the grantee at the grantor's death, (12) promissory notes, given for consideration, payable at or after the maker's death, (13) life insurance contracts, (14) life insurance trusts, (15) annuity contracts and retirement programs with survivorship provisions, (16) gifts *causa mortis*, (17) gifts absolute, particularly those made in contemplation of death but with death not made a condition, (18) contracts of all kinds and of infinite variety in which the obligation owed by one party is not due until his death or the death of the other party, including leases, releases, employment contracts, retirement programs of all types, third party beneficiary contracts, contracts to make wills, and the like.[8]

This Article will not discuss all of the above-enumerated will substitutes but will only describe the most commonly used types in the United States and some of those which were or are still in use in the Philippines, namely: joint tenancies, joint bank accounts, payable-on-death (P.O.D.) accounts, revocable or living trusts, and contractual benefits payable-at-death. The main discussion and analysis will be reserved to the first two types enumerated above—joint tenancies and joint bank accounts, for they are both characterized by the *right of survivorship*, to which validity has been accorded by the Supreme Court. Thus, the Court, wittingly or unwittingly, has disturbed the once quiet shores of the laws on succession with the

8. BLACK'S LAW DICTIONARY 1601 (6th ed. 1990).

lapping of these persistent tides of change[9] known collectively as will substitutes.

Joint Tenancies. This system allows two or more individuals to own an undivided equal interest in property. When one joint tenant dies, his property interests pass immediately to the remaining joint tenants in equal shares. Joint tenancies are similar to co-ownership, except that in the latter no right of survivorship accrues. Joint tenancy is often used for the holding of title to real estate, cars, bank accounts, stocks, bonds, and mutual funds.

Joint Bank Accounts. These are deposits in the name of two or more persons which grants either party the right to make unlimited withdrawals, regardless of who deposited the money. Each joint owner will be able to withdraw money from the account freely, without need for the other joint owner's permission. One of the basic features of a joint account is the *right of survivorship.* This means that the money left in the account after one joint owner dies automatically goes to the surviving joint owner. The validity of this type of will substitute has been upheld by the Court in two cases spaced between five decades.

Revocable or Living Trust. This is the third method of transferring assets outside of probate under which falls the P.O.D. account.

A trust is a relationship where a person, called a trustor, transfers something of value to another person, called a trustee. The trustee then manages and controls the property placed in the trust for the benefit of a third person, called a beneficiary. In managing the property, the trustee must comply with the terms of the trust and such other requirements established by law.

Trusts are most commonly created under the terms of a will or in a separate written document known as a *trust agreement.* A trust which does not become effective until the trustor has died is known as a *testamentary trust.* A trust created while the trustor is alive is known as a *living trust.* It may either be revocable or irrevocable. Property placed in a revocable trust can be removed by the trustor at any time, at the trustor's discretion. As such, they are popular will substitutes since unlike joint bank accounts, the trustor generally retains the right to the income of the trust for life as well as the power to amend, alter, or revoke the trust in accordance with its terms while granting the trustee legal title to the property. However, placing property in an irrevocable trust is the same as making a gift—one gives up ownership and control forever.

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9. Kara Peischl Marcus, *Totten Trusts: Pragmatic Pre-Death Planning or Post-Mortem Plunder?*, 69 TEMP. L. REV. 861 (1996).

In the United States, P.O.D. bank accounts offer one of the easiest ways to keep large sums of money out of probate. Payable-on-death refers to the transfer of a monetary account, usually a bank account, from one to a beneficiary after one's death. These accounts are also sometimes called tentative trusts, informal trusts, revocable bank account trusts, the *poor man's trust*, and *Totten trusts*[10] after the title of the case which secured its validity.

All one needs to do is properly notify the bank of the account beneficiary and after the former dies, the latter merely presents the death certificate, proof of his or her identity, and any other required documentation. He then becomes the owner of the account. Its name *poor man's trust* is apt because a P.O.D. account does accomplish for a bank account—for free—exactly the same results as would an expensive, lawyer-drawn trust.[11]

Contractual Benefits Payable at Death. They are the most used means to transfer property without going through probate. These include life insurance contracts,[12] death benefits under retirement plans and social security benefits.

Life insurance policies are analogous to wills in that the beneficiary designation is revocable until the testator's death and the designated beneficiaries have an *expectancy* or an *ambulatory* interest. However, contract law, rather than the laws on succession, governs because life insurance policies are non-testamentary dispositions. When the insured dies, the insurance company pays the policy's assets to the designated beneficiary. In fact, as a life insurance policy is a contract between the owner, the insurance company, and the beneficiary, a will cannot override the beneficiary designation on the policy; it is the provisions, terms and conditions regarding revocation of the beneficiary which must be followed.

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10. *See In Re* Totten, 179 N.Y. 112, 71 N.E. 748 (1904).

11. *See* PAUL HASKELL, PREFACE TO WILLS, TRUSTS AND ADMINISTRATION 122 (1994) (It may seem similar to joint bank accounts with a survivorship agreement except that in the former for as long as the benefactor is alive, the beneficiary named to inherit the money in a payable-on-death account has no rights over it, which accrue only after the former's death. Some United States commentators opine that this is a straightforward circumvention of their will and intestacy statutes since it is obviously testamentary in nature.) Nevertheless, the Uniform Probate Code and statutes in about half the states validate this type of survivorship provision.

12. *See* AMERICAN COUNCIL OF LIFE INS., LIFE INSURANCE FACT BOOK 1990, 5, 45 (1990) (A study in the United States found that life insurance policies constitute the majority of non-probate dispositions of property.).

Similarly, pension and employee benefit plans, and social security benefits which also have features analogous to wills, are gaining popularity as a primary source of non-probate disposition. As in the case of life insurance proceeds, benefits payable to a named death beneficiary, rather than to the decedent's estate, are not included in the decedent's probate estate.

When these will substitutes are created properly, each is "functionally indistinguishable from a will"—each reserves complete control for the owner during his or her lifetime, including the power to designate and revoke beneficiaries, and vests in the beneficiary upon the decedent's death.

It should be pointed out that at first glance, these different types of will substitutes are really testamentary in nature, but as mentioned, United States case law has held otherwise. The succeeding sections will evaluate the rationales given by United States courts to determine if such would hold true in the Philippine setting.

This Article is organized so that the first shall be last and the last shall be first. Given this truism, contractual benefits payable upon death shall be discussed first.

II. WILL SUBSTITUTES AT COMMON LAW AND CIVIL LAW

A. Contractual Benefits Payable at Death

A contract is seldom held testamentary in character merely because it is performable after the death of one of the parties. Thus, contracts which are payable by the insurance carrier to a named beneficiary upon the death of the insured are generally held not testamentary even though the right to change the beneficiary is reserved.[13] Under Philippine tax laws, the proceeds of a life insurance policy are not included in the decedent's probate estate, if payable to a named beneficiary irrevocably designated rather than to the decedent's estate or to a personal representative of the estate. If revocably designated, the life insurance proceeds are included in the estate but only for purposes of computing the appropriate estate taxes. The proceeds shall still belong to the beneficiary. However, a life insurance policy purchased by a person on the life of another will be included in the policy owner's (purchaser's) probate estate in the event that he or she predeceases the person whose life is insured.

13. VANCE, INSURANCE 679-681 (3rd. ed., 1951).

The principal law on insurance is the Insurance Code of 1978;[14] the Civil Code applies only in a suppletory character. In *Del Val v. Del Val,*[15] the Court held that the contract of life insurance is a special contract and the destination of the proceeds thereof is determined by special laws which deal exclusively with the subject. The Civil Code contains no provisions relating directly and specifically to life-insurance contracts or to the destination of life-insurance proceeds. This is regulated exclusively by the contract, the relations of the parties and the destination of the proceeds of the policy. Thus, if the beneficiary predeceases the insured, and the insured later dies, the insurance indemnity will be given to the heirs of the beneficiary, and *not* the heirs of the insured. This is because generally, the beneficiary has a vested right to the indemnity. The rules on testamentary succession cannot apply here, for the insurance indemnity does not partake of a donation. It cannot be considered as an advance of the inheritance and is not subject to collation.

Akin to the insurance contract are the various forms of pension and employee benefit programs, most of which provide some form of death benefits that pass outside estate administration. Most widespread of these is the social security system. As in the case of life insurance proceeds, benefits payable to a named beneficiary rather than to the decedent's estate or to a personal representative of the estate are not included in the decedent's probate estate.

It is worth noting that the Court has ruled upon the validity of these types of dispositions. In *Social Security System v. Davac,*[16] the Court held that

> [t]he benefit receivable under the Social Security Act is in the nature of a special privilege or an arrangement secured by the law, pursuant to the policy of the State to provide social security to the workingmen. The amounts that may thus be received cannot be considered as property earned by the member during his lifetime, and, hence, do not form part of the properties of the conjugal partnership or of the estate of the said member.[17]
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> ...if there is a named beneficiary and the designation is not invalid, it is not the heirs of the employee who are entitled to receive the benefits, unless they are the designated beneficiaries themselves. It is only when there is no designated beneficiary or when the designation is void that the laws of

14. A Decree to Consolidate and Codify all the Insurance Laws of the Philippines [INSURANCE CODE OF 1978], Presidential Decree No. 1460 (1978).

15. Del Val v. Del Val, 29 Phil. 534 (1915).

16. Social Security System v. Davac, 17 SCRA 863 (1966).

17. *Id.* at 867.

> succession become applicable. *The Social Security Act is not a law of succession.*[18]

As regards non-designation of beneficiaries in *In Re: Claims for Benefits of the Heirs of the Late Mario Chanliongco*,[19] the Court had this to say:

> [a]ccording to law, the benefits accruing to the deceased consist of: (1) retirement benefits; (2) money value of terminal leave; (3) life insurance proceeds; and (4) refund of retirement premiums…he failed or overlooked to state in his application for membership with the GSIS the beneficiary or beneficiaries of his retirement benefits, should he die before retirement. *Hence, the retirement benefits shall accrue to his estate and will be distributed among his legal heirs in accordance with the law on intestate succession, as in the case of a life insurance if no beneficiary is named in the insurance policy.*[20]

Under the Tax Code,[21] only proceeds of life insurance are generally included in the computation of estate taxes. Proceeds of insurance policies issued by the Government Service Insurance System (GSIS) to government officials and employees are exempt by law from taxes of all kinds,[22] as well as those benefits accruing under the Social Security Act.[23]

Proceeds of life insurance are taxable only when the estate of the deceased is the beneficiary, or if the beneficiary is other than the decedent and such designation is revocable. The amount receivable by an irrevocably designated beneficiary is free from tax because the transfer is absolute and the insured did not retain any legal interest in the insurance.

Even the State recognized the ambulatory character of insurance contracts when it provided that the designation of the beneficiary is

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18. Tecson v. SSS, 32 SCRA 735 (1961) *cited in* SSS v. Davac, 17 SCRA 863, 868 (1966). (*emphasis supplied*)

19. *In Re:* Claims for Benefits of the Heirs of the Late Mario Chanliongco, 79 SCRA 364 (1977).

20. Vda. de Consuegra v. GSIS, 37 SCRA 315 (1971) *cited in In Re:* Claims for Benefits of the Heirs of the Late Mario Chanliongco 79 SCRA 364, 366 (1977).

21. An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes [NATIONAL INTERNAL REVENUE CODE], Republic Act No. 8424 (1998).

22. Amending, Expanding, Increasing and Integrating the Social Security Insurance Benefits of Government Employees and Facilitating the Payment Thereof under Commonwealth Act No. 186, as Amended, and for Other Purposes, Presidential Decree No. 1146 (1977).

23. An Act to Create the Social Security System Providing Sickness, Unemployment, Retirement, Disability and Death Benefits for Employees, Republic Act No. 1161 (1954).

revocable and that proceeds are includible in the gross estate of the decedent, unless it is expressly stipulated that the designation is irrevocable;[24] because it is only in the latter case where the right to the proceeds immediately vests from the insured to the beneficiary.

The State has recognized that, except in cases of irrevocable beneficiary designation, the insured still retains interest in the insurance proceeds. Particularly if it is a policy with cash value, the insured may at any time terminate the contract and take out the cash value. The insured retains full control during life and disposes of the property at death by means of the beneficiary designation. This disposition by death is testamentary in nature, but its validity, despite its informality *vis-a-vis* the forms of wills, has been established for many years on contract theory. It is argued that the money paid to the beneficiary comes not from the decedent's estate but from the insurance company, hence it is not a *mortis causa* disposition. Despite this, the State still allows inclusion of certain life insurance proceeds in the computation of estate taxes. The State is thus well insulated, which is not the case for both the creditors and the heirs, with respect to their legitime. In the case of heirs, it is even more iniquitous since the proceeds are not subject to collation.

B. Revocable Trusts

Trusts are most commonly created under the terms of a will or in a separate written document known as a *trust agreement.* A trust which does not become effective until the trustor has died is known as a *testamentary trust.* A trust created while the trustor is alive is known as a *living trust.* Trusts can also be either *revocable* or *irrevocable.* Property placed in a revocable trust can be removed by the trustor at any time, at his discretion. However, placing property in an irrevocable trust is the same as making a gift—one gives up ownership and control forever.

Trusts have several uses and can be of much benefit when they are properly set up. One common use is to provide flexible control of assets for the benefit of minor children. This often avoids the necessity of appointing a guardian to manage property inherited by minor children.

It is not difficult to imagine the difficulty that most 18-year olds would have with managing a large sum of money given to them in one lump sum. By establishing a trust, parents can select a trustee and specifically instruct them on how to use the assets for the benefit of the children. They can also

24. INSURANCE CODE OF 1978, §11.

allow the trustee much more flexibility in managing those assets than a court appointed guardian would have.[25]

In some instances, a trust can serve as an alternative to a will. For example, an older person may create what is called a *living, revocable trust* by transferring most of his assets to the trust and then simply collecting the income for the remainder of his lifetime.[26]

A living trust does not eliminate the need for a will and probate unless every asset the trustor owned is transferred to the trustee prior to death. However, there is a type of revocable living trust which has been held not subject to probate even if only a certain portion of the estate is placed in trust to a specified beneficiary as in the case of P.O.D. accounts.

P.O.D. accounts go by numerous different names. Banks, for example, may respond to a request for a P.O.D. account by handing a form that authorizes the creation of something called a *Totten trust.*[27] Such accounts are also called tentative trusts, informal trusts, revocable bank account trusts or the *poor man's trust.*

Setting up a P.O.D. bank account is simple: when one opens an account, the beneficiary's name is merely listed on the signature card. The beneficiary of a P.O.D. account, who is commonly referred to as a P.O.D. *payee*, does not have to sign anything. All he or she has to do to claim the money is show the bank a certified copy of the death certificate and proof of his or her identity. The bank records will show that the beneficiary is entitled to whatever money is in the account.

United States state laws authorize banks to release the money in P.O.D. accounts when they are shown proof of the account holder's death; probate court approval is not required. Legally, the money automatically belongs to the beneficiaries when the original account owner dies. It is not under the control of the probate court.

States have found some ways to regulate these accounts, one of which is the delay beneficiaries encounter when they are made to comply with

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25. For instance, the trust may provide that a larger share of trust benefits may be directed toward the care of a disabled child with special needs. This kind of trust is most often included in a will and does not become effective until both parents have died. It is usually set up to provide for the support, care and education of the children until they have reached the age when the trust assets must be distributed outright.

26. Such trusts are often revocable because trustors are reluctant to give up the right to change or even cancel the trust at any time.

27. Totten trusts are really just P.O.D. accounts.

stricter procedural requirements such as tax clearances. Like other bank accounts, a P.O.D. account may be temporarily frozen upon the benefactor's death, if death taxes are levied. The bank will release the money only when the state is satisfied that the estate can pay taxes.

The first recorded case in the United States which addressed this form of will substitute occurred much earlier than *In Re Totten.*[28] In *Witzel v. Chapin*,[29] William Witzel deposited opened a savings account and wrote "in trust for Ann Witzel" on the bank book cover. These words were the only manifestation of William's intent to create a trust. Upon his death, the designated beneficiary claimed the remaining assets. In upholding the trust, the court noted that the deposit raised a rebuttable presumption that a valid trust existed, as did the fact that William did not revoke the trust before his death. The court articulated a doctrine under which a valid trust can arise from the deposit of money "in trust" for another, absent a showing that the depositor did not intend to establish such a trust.

Subsequent to Witzel, various state cases altered the doctrine that the Witzel court had set forth. Courts upheld Witzel-type trusts only if the trust was construed as *irrevocable.* Commentators have attributed subsequent courts' hesitation to apply the Witzel rule to their rejection of the reasoning and outcome in the Witzel decision. Hence, when *In re Totten* arose in 1904, the New York Court of Appeals faced squarely the task of restoring or permanently invalidating the ruling in Witzel.[30]

The Totten court ruled that revocable trusts were acceptable dispositions of property.

> A deposit by one person of his own money in his own name as trustee for another, standing alone, does not establish an irrevocable trust during the lifetime of the depositor. It is a tentative trust merely, revocable at will, until the depositor dies or completes the gift in his lifetime by some unequivocal act of declaration, such as delivery of the passbook or notice to the beneficiary. In case the depositor dies before the beneficiary without revocation, or some decisive act or declaration of disaffirmance, the presumption arises that an absolute trust was created as to the balance on hand at the death of the depositor.[31]

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28. *In Re* Totten, 179 N.Y. 112, 71 N.E. 748 (1904).

29. Witzel v. Chapin, 3 BRADF. SURR. 386 (N.Y. SUR. CT. 1855).

30. The court noted that numerous conflicting cases regarding trusts and the necessity to settle the conflict by laying down such a rule as will best promote the interests of the people in the state.

31. *In Re* Totten, 179 N.Y. 112, 71 N.E. 748 (1904).

While common law commentators and practitioners have both praised and criticized the Totten ruling, it has been and still is beneficial to persons of modest means who wish to dispose of a small amount of money at death. A *Totten trust* also lowers the costs of transmitting wealth for all individuals, eliminates the lengthy delays of the probate process, and generally increases accessibility to estate planning methods. The *Totten trust* allows the general public access to estate planning—creating a *Totten trust* merely requires the assistance of bank personnel. And upon the depositor's death, the bank personnel also assist the beneficiary in obtaining the trust assets.[32]

Notwithstanding its advantages, eminent jurists argue that there are several disadvantages and problems associated with its doctrine—is the bank liable to third parties who challenge the beneficiary's right to the funds of the Totten trust? What happens to the account if the beneficiary predeceases the depositor? May the funds be used to pay funeral and estate administration expenses? May the decedent's creditors reach the funds? May the decedent's family, specifically the heir's, reach the funds?

As the discussion on *Totten trusts* is grounded purely on common law, a discussion of its treatment as to civil law is now apropos. Trusts are classified as either express or implied. Express trusts are created by the intention of the trusts or of the parties. No particular words are required for the creation of an express trust, it being sufficient that a trust is clearly intended. On the other hand, implied trusts come into being by operation of law. The doctrine that governs such is founded on equity.[33]

The Philippines has a different treatment on trusts as compared to the United States; nowhere in the Civil Code can one find the terms revocable or irrevocable trusts, P.O.D., or *Totten trusts*. However, this does not mean that such kinds of trusts are inexistent, they are merely denominated as express trusts.

Similar to insurance policies, the State is well insulated from the use of trusts as a means to circumvent revenue laws particularly with regard to payment of estate taxes.[34]

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32. *See* Marcus, *supra* note 9.

33. The principle is applied in the American legal system to numerous cases where an injustice would result if the legal estate or title were to prevail over the equitable right of the beneficiary.

34. NATIONAL INTERNAL REVENUE CODE, §63 ("Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested (1) in the grantor either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or (2) in any person not having a substantial adverse interest

As an added safety net, some *inter vivos* transfers are also made subject the tax. The gross estate extends to gratuitous transfers made by the decedent during his lifetime which are treated by law as substitutes for testamentary dispositions where certain circumstances provided by law are present.[35] These transfers may be grouped as follows: (1) transfers in contemplation of death; (2) transfers with retention or reservation of certain rights: (3) revocable transfers; (4) transfers of property arising under a general power of appointment; and (5) transfers for insufficient consideration.

In most of these transfers, the property remains substantially that of the transferor during his lifetime, notwithstanding the transfer, as he still retains either the *beneficial ownership* or *naked title* to the property. Hence, the transfer is essentially upon the death of the owner.

In order to be exempted from the purview of the taxing provisions, the transfer by *inter vivos* must be absolute. Transfers by virtue of a *bona fide* sale of property for an adequate and full consideration in money or money's worth are excluded and thus, not taxable. A transfer of property by trust or donation is not "consummate until put beyond recall."[36] The dominant purpose of the law is to reach such transfers which are really substitutes for testamentary dispositions and "thus to prevent the evasion of the estate tax."[37]

It is unfortunate that creditors and heirs are not given the same remedy by the State. Whereas the latter is given a chance to bypass the trust and consider it virtually inexistent in order to collect the *proper* taxes, compulsory heirs and legitimate creditors have no hope of getting their *proper* share in the estate for as to them the trusts are valid and binding.

C. Survivorship Rights via Contract and Joint Ownership

1. Joint Tenancy

Under common law, *co-tenancy* refers to the ownership of property by two or more persons in such a manner that they have an undivided possession or right to possession, but several freeholds. It includes joint tenancies and tenancies in common which share certain characteristics but differ markedly

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in the disposition of such part of the corpus or the income therefrom, the income of such part of the trust shall be included in computing the taxable income of the grantor.").

35. These are transfers which are *inter vivos* in form but *mortis causa* in substance.

36. Burnet v. Guggehein, 288 U.S. 280 (1933).

37. United States v. Wells, 283 U.S. 102 (1931).

in several respects.[38] *Tenancies in common* is covered by the Civil Code, under the provisions on co-ownership. On the other hand, *joint tenancy,* with its feature of survivorship, is of questionable applicability in the Philippine jurisdiction.

Courts today continue to resolve disputes concerning the creation and severance of joint tenancies by reference to Blackstone's classic formulation of the Doctrine of the Four Unities:

> [t]he properties of a joint estate are derived from it's unity, which is fourfold; the unity of interest, the unity of title, the unity of time, and the unity of possession: or, in other words, joint- tenants have one and the same interest, accruing by one and the same conveyance, commencing at one and the same time, and held by one and the same undivided possession.[39]

Each joint tenant has equal undivided interest in the whole of the property. If it is the land, each grain of the earth is owned by the joint tenants concurrently, and if it is a certificate for 100 shares of corporate stock, each share is owned by the joint tenants concurrently. A joint tenant cannot claim any part of the property as his exclusively. This type of ownership applies to both personal property and real property. The disability of a person constitutes no impediment in forming a joint tenancy. Moreover, any two persons may enter into a joint tenancy relationship, they need not be husband and wife,[40] they may even live together in an illicit relationship which in no way would preclude them from holding property jointly.[41]

As defined above, joint tenancy may be mistaken for co-ownership, but they are not the same. Unlike joint tenancy, tenancy in common or co-ownership is characterized by a single essential unity—possession of the co-owned property. What distinguishes joint tenancy from tenancy in common or co-ownership

> is that the surviving co-owner in joint tenancy is subrogated in the rights of the deceased co-owner immediately upon the death of the latter, by the mere fact of said death, but this does not take place in cases of tenancy in common which corresponds to what is known in our law as community of property...according to American jurisprudence, a co-owner in joint tenancy cannot dispose of his share or interest in the property which is the

38. *Cotenacy and Joint Ownership*, 20 AMJUR 2D §16, 106 (1964).

39. John V. Orth, *Joint Tenancy Law*, 5 GREEN BAG 2D 173 (2002).

40. However in community property states, community property cannot be held in joint tenancy since it is inconsistent with the testamentary power of each spouse over half of the community property. *See* Note, *Non-Probate Transfers – Provisions Relating to Effect of Death,* 12 CREIGHTON L.REV. 1173 (1979).

41. *Co-Tenancy and Joint Ownership, supra* note 38, at § 6 .

> subject matter of the joint tenancy, without the consent of the other co-owner because in so doing he prejudices the other's rights and interests. In both tenancy in common or co-ownership and joint tenancy, the property held involves a physical whole, but in the former there is an ideal or abstract division between or among the co-owners, each co-owner being the owner of his own ideal share. But in the latter concept there is no ideal or abstract division, each and all of them own the whole thing. Thus in tenancy in common, each co-owner may dispose of his ideal or undivided share without the other's consent, whereas in joint tenancy each joint tenant may not dispose of his own share without the consent of all the rest. The third distinction was the subject in the Tagarao case. [42]

This is the distinctive incident of the joint tenancy—the right of survivorship or *jus accrescendi*, meaning that on the death of one joint tenant, that tenant's share accrues to the surviving tenant or tenants. The share of the deceased joint tenant automatically goes to the surviving joint tenants. There is no probate administration which is ordinarily required, since the property automatically passes to the surviving joint tenants; such property is thus not included in the inventory of assets of the estate. Taxes, claims of both creditors and heirs are legally avoided.

The very first case in the Philippines which involved will substitutes or non-probate assets was *Macam v. Gatmaitan*.[43] Two friends, Gatmaitan and Macam, who had lived together for some time, agreed in writing that the house which they bought with the money belonging to Macam and the Buick automobile and certain furniture which belonged to Gatmaitan shall belong to the survivor upon the death of one of them and that "this agreement shall be equivalent to a transfer of the rights of the one who dies first and shall be kept by the survivor."[44] After the death of Macam, her executrix assailed that document on the ground that with respect to the house, the same constituted a donation *mortis causa* by Macam in favor of Gatmaitan. In absolving the defendants from the complaint, the Court said:

> ...Exhibit C is an aleatory contract whereby, according to article 1790 of the Civil Code, one of the parties or both reciprocally bind themselves to give or do something as an equivalent for that which the other party is to give or do in case of the occurrence of an event which is uncertain or will happen at an indeterminate time. As already stated, Leonarda was the owner of the house and Juana of the Buick automobile and most of the furniture. By virtue of Exhibit C, Juana would become the owner of the house in case Leonarda died first, and Leonarda would become the owner of the automobile and the furniture if Juana were to die first. In this

42. Tagarao v. Garcia, 61 Phil. 5, 19-20 (1934).

43. Macam v. Gatmaitan, 64 Phil. 187 (1937).

44. *Id.* at 188-90.

> manner Leonarda and Juana reciprocally assigned their respective property to one another conditioned upon who might die first, the time of death determining the event upon which the acquisition of such right by the one or the other depended. This contract, as any other contract, is binding upon the parties thereto. Inasmuch as Leonarda had died before Juana, the latter thereupon acquired the ownership of the house, in the same manner as Leonarda would have acquired the ownership of the automobile and of the furniture if Juana had died first.[45]

The Court reasoned that the questioned agreement was an aleatory contract and not a donation *mortis causa*, but it could be argued that the agreement was, in reality, a joint tenancy agreement. Applying Blackstone's Doctrine of the Four Unities: unity of interest, unity of title, unity of time, and unity of possession, there is no question that there was unity of possession, time and interest. However, what appeared to be lacking was the unity of title. The agreement would unite the title to the various properties upon the death of one party in the name of the surviving party.[46]

However, no matter how close friends Macam and Gatmaitan were under Philippine laws on succession, they were actually mere strangers, and if they wanted to give effect to their agreement they should have made a will devising such property to the other. By entering into a survivorship agreement, they really intended to enter into a joint tenancy relation where both of them would succeed the other without going through probate; however despite their intention, such agreement was carefully worded to explicitly avoid a joint tenancy relation. Nevertheless, by validating such agreement, by designating the same as an aleatory contract, the Supreme Court has accepted *sub silencio,* the concept of joint tenancy with its salient feature of survivorship.

During the joint tenant's life, his interest could be reached by his creditors. Joint tenants may unilaterally sever or partition the joint tenancy during the lifetime of the joint tenants. Similarly, a judgment creditor may, during the life of the judgment debtor, bring a judgment creditor suit to have the partition and sale of the property ordered. Under the common law rule, this forced severance is necessary to protect the creditor's rights prior to the death of the joint tenant.[47]

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45. *Id.* at 190-91.

46. In contrast, United States courts tend to place less emphasis on formalistic requirements and more on the intention of the parties with respect to the creation of a joint tenancy.

47. Martin D. Begleiter, *Attorney Malpractice in Estate Planning – You've Got to Know When to Hold Up, Know When to Fold Up*, 38 U. KAN. L. REV. 193, 230-31 (1989).

When a joint tenant dies his interest moves to the survivor without an instrument of transfer or estate administration. That interest which passes is not subject to the claims of the deceased joint tenant's creditors. At his death, his interest disappears, so there is nothing for the creditors to reach. The vulnerability of the creditor before such survivorship rights is a facet of joint tenancy that has generated some concern in recent years. Strangely, laymen and even those whose very rights may be affected by this, like creditors (and forced heirs)[48] seem little aware of this important attribute of joint tenancy.[49]

2. Joint Bank Accounts

The essence of a deposit account is the delivery by an individual of money or its equivalent to a bank. The customer expects repayment of the money, typically upon his or her demand and upon the terms and conditions set forth in a deposit contract. The consumer is a creditor—a person to whom an obligation is owed. Conversely, the bank is the debtor—the one who owes the obligation. The term *account* is appropriate, as the deposit creates, essentially, an account receivable for the depositor and an account payable for the bank.[50]

As a *joint deposit account* is a type of deposit account, it creates a contractual relationship between the bank and the depositors. It is an account for which two or more parties, jointly, are entitled to demand or to order the bank, payment of the account balance.[51]

Individuals establish such an account for varied reasons. The account may be established for the banking convenience of husbands and wives. The account may also be established by one person to deposit a cash gift for another, but over which the benefactor will retain control so that the other person named on the account will receive the money only for a specific purpose or at a specific time.[52]

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48. The term *forced heirs* is added by the Author since most commentators hardly bother discussing the same.

49. Brian Layman, *Perpetual Dynasty Trusts: One of the Most Powerful Tools in the Estate Planner's Arsenal,* 32 AKRON L. REV. 747, 761 (1999).

50. John W. Fisher, *Joint Tenancy in West Virginia: A Progressive Court Looks at Traditional Property Rights,* 91 W. VA. L. REV. 267, 287 (1989).

51. For many individuals and banks however, the joint deposit account is perceived as simply a deposit account for which two names are noted in the signature line of the deposit contract.

52. Thus, it has been equated by some quarters as some form of *a poor mans will* established so that upon the depositors death, the account will be paid to the

In *Rivera v. People's Bank and Trust Co.*,[53] Stephenson opened a joint bank account with his housekeeper Rivera. Upon the former's death, the latter sought to collect the balance on the account but the bank refused. Rivera then instituted an action against the bank. The administratrix of Stephenson's estate intervened and claimed the amount as forming part of the exclusive property of the deceased.

The administratrix argued that Rivera, being a mere househelp, was only given a power of attorney to withdraw funds from the account which power terminated upon the principal's death. While this line of reasoning by the administratrix of the estate brought into fore the concept of joint deposits for convenience,[54] the question of whether or not the original depositor intended a joint account for his own convenience or for the benefit of the non-depositing payee is a factual question to be determined from all facts and circumstances in the particular case.[55]

The Court held that the administratrix's conclusion was wrong and based on the erroneous assumption that Stephenson was the exclusive owner of the funds deposited. The Court noted that Rivera served her master for 19 years without actually receiving her salary. And as Stephenson subsequently transferred the account to the name of *himself and/or Rivera* and executed with the latter the survivorship agreement, absent a relation other than of master and servant, this nullified the assumption that Stephenson was the exclusive owner of the bank account.[56]

The administratrix also argued that the survivorship agreement was really a donation *mortis causa* from Stephenson to Rivera and since it was not executed with the formalities of a will, it can have no legal effect. The Court again denied this contention by saying that in the first place, Stephenson was not the sole owner of the account, he was a only *co-tenant*

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other party named on the account.

53. Rivera v. People's Bank and Trust Co., 73 Phil. 546 (1942).

54. In other words, the alleged donee acquires no ownership in the deposit, or any part thereof, where the only purpose for creating the joint account is to enable the donee to draw funds for the benefit of the donor implying thus that Rivera was only made a co-depositor only to pay the bills or other necessary expenses without the need to wait for her employer's approval.

55. *See* 10 AMJUR 2D, *Banks* §374 (1964).

56. *Rivera*, 73 Phil. at 547 ("In the absence, then, of clear proof to the contrary, we must give full faith and credit to the certificate of deposit, which recites in effect that the funds in question belonged to Edgar Stephenson and Ana Rivera; that they were joint owners thereof; and that either of them could withdraw any part or the whole of said account during the lifetime of both, and the balance, if any, upon the death of either, belonged to the survivor".).

thereof. How can it be a donation *mortis causa* from Stephenson to Rivera when the latter already owned the funds even before the former's death? The problem is that the Court neglected to take note of the fact that neither Rivera or Stephenson exclusively owned the account, they were merely co-owners, or as they put it *joint tenants* and they had only inchoate interest over their share.

A careful perusal of the survivorship agreement will show that they referred to their relationship as one of joint tenancy. Joint tenancy, as stated, is a common law concept which is distinct from the civil law concept of co-ownership or tenancy in common. This case was decided in April 1942, only five years after Macam, several years prior to the New Civil Code, and when the Philippines was under American rule, so it is probable that the Court decided with this common law concept in mind. But despite the erroneous designation that the joint bank account *resembles* a joint tenancy, it is actually not a joint tenancy.

The agreement in this case intended that both Rivera and Stephenson may use the account for his or her needs and that the survivor should have the balance at the death of the other. According to United States case law, the principal reason why this is not a joint tenancy in a claim against the bank is that one depositor may properly draw out *more than one-half* the account. In a joint tenancy, the interests must be equal.[57] But in the Philippine jurisdiction, whether or not a joint bank account is in fact a joint tenancy makes no difference, since the Philippines follows the concept of co-ownership where there is no right of survivorship.

Assuming that in the case of Rivera, only Stephenson contributed to the account (since the Court found that both contributed, since the former did not receive any salary despite 19 years of service), and Stephenson subsequently died, if Rivera was entitled to the account balance, on what theory is this rationalized? The joint account agreement was not signed in accordance with the formalities for a will, thus under Philippine laws, the account should pass through the decedent's intestate estate. The Court, in coming up with the rationale upholding the transfer to Rivera upon Stephenson's death, merely restated *verbatim* its ratio enunciated in Macam.

What the Court held in these two cases is that the co-depositors and the bank contracted that the surviving party was to receive the balance in the account at the other party's death. The transfer, if seen in that light, is not a testamentary disposition but rather a *contractual payment* caused by another's death. This is the same reasoning used by courts in according validity to life insurance payments to beneficiaries, as they are not an invalid testamentary

57. PAUL HASKELL, PREFACE TO WILLS, TRUSTS AND ADMINISTRATION 120 (1994).

disposition for failure to comply with the requirements of a will, but rather a contractual payment caused by the death of the insured.[58]

To clarify, joint tenancy has not been abolished in common law systems; it was only modified to the effect that the ancient common law presumption favoring joint tenancies has been reversed, and the presumptions are now almost wholly in favor of tenancies in common. This means that in construing a grant to two or more persons, the courts will regard it as creating a tenancy in common unless a contrary intent, sufficient to negative the presumption arising from the statute, plainly appears in the instrument itself. Of course, regardless of the form of the statute, if the instrument contains nothing indicative of a joint tenancy, the parties will not be deemed joint tenants. If such an intention appears, however, the courts are bound to give it effect as they have no right to deprive the parties of their right to convey property in such manner as they may desire under the law. The words *joint tenancy* need not always be used to create a joint estate under such statutes. An intention to create a joint estate must, however, somehow appear. And it has been said that the most important element of a joint tenancy, in personal property at least, is the intent of the creators that the right of survivorship shall exist.[59] Be that as it may, the argument is misplaced and is purely academic since the Philippines has never expressly embraced the concept of joint tenancy.

These two cases of *Macam* and *Rivera* were again reiterated five decades later in the case of *Vitug v. Court of Appeals*.[60] Vitug withdrew sums of money from a savings account in the Bank of America, Makati. Corona opposed such withdrawal on the ground that the same funds were conjugal partnership properties and formed part of the estate. In addition to such opposition, Vitug's ouster as special administrator was also sought for failure to include the sums in question for inventory and for concealment of funds belonging to the estate. Vitug, on the other hand, insisted that the funds in question were his exclusive property having acquired the same through a survivorship agreement with his late wife and the bank.

While the trial court upheld the validity of this agreement, the Court of Appeals reversed such decision, and held, firstly, that the survivorship

58. *Rivera*, 73 Phil. at 548 (the Court summed up its position in Rivera stating "[f]urthermore, it is well established that a bank account may be so created that two persons shall be joint owners thereof during their mutual lives, and the survivor take the whole on the death of the other. The right to make such joint deposits has generally been held not to be done away with by statutes abolishing joint tenancy and survivorship generally as they existed at common law.").

59. *Banks, supra* note 54, § 17.

60. Vitug v. Court of Appeals, 183 SCRA 755 (1990).

agreement constituted a conveyance *mortis causa* which did not comply with the formalities of a valid will, and secondly, even assuming that it was a mere donation *inter vivos*, the same was a prohibited donation under the Civil Code.

However, the Supreme Court reversed the Court of Appeals and reinstated the trial court's decision, stating thus:

> 1. ...[i]n *Rivera v. People's Bank and Trust Co.*, we rejected claims that a survivorship agreement purports to deliver one party's separate properties in favor of the other, but simply, their joint holdings.
>
> 2. There is no showing that the funds exclusively belonged to one party, and hence it must be presumed to be conjugal, having been acquired during the existence of the marital relations.
>
> 3. Neither is the survivorship agreement a donation *inter vivos*, for obvious reasons, because it was to take effect after the death of one party. Secondly, it is not a donation between the spouses because it involved no conveyance of a spouse's own properties to the other.
>
> 4. ...In the case at bar, when the spouses Vitug opened savings account No. 35342-038, they merely put what rightfully belonged to them in a money-making venture. They did not dispose of it in favor of the other, which would have arguably been sanctionable as a prohibited donation. And since the funds were conjugal, it can not be said that one spouse could have pressured the other in placing his or her deposits in the money pool.
>
> 5. The validity of the contract seems debatable by reason of its "survivor-take-all" feature, but in reality, that contract imposed a mere obligation with a term, the term being death. Such agreements are permitted by the Civil Code.
>
> ...the fulfillment of an aleatory contract depends on either the happening of an event which is (1) "uncertain," (2) "which is to occur at an indeterminate time." A survivorship agreement, the sale of a sweepstake ticket, a transaction stipulating on the value of currency, and insurance have been held to fall under the first category, while a contract for life annuity or pension under Article 2021, *et sequentia*, has been categorized under the second. In either case, the element of risk is present. In the case at bar, the risk was the death of one party and survivorship of the other.

Similarly, all of these cases ended in a unison caveat from the Supreme Court. In Rivera,

> ...as we have warned, the survivorship agreement is *per se* not contrary to law, but its operation or effect may be violative of the law. For instance, if it be shown in a given case that such agreement is a mere cloak to hide an inofficious donation, to transfer property in fraud of creditors, or to defeat the legitime of a forced heir, it may be assailed and annulled upon such

grounds. No such vice has been imputed and established against the agreement involved in this case.

The same is reiterated in the case of Vitug.[61]

Another case involving the legality of Joint bank accounts would have been *Commissioner of Internal Revenue v. Concepcion*,[62] however, the Court denied the petition on other grounds as prescription.[63]

Another case involving the legality of Joint bank accounts would have been *Commissioner of Internal Revenue v. Concepcion*,[64] however, the Court denied the petition on other grounds as prescription.[65]

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61. *Rivera*, 73 Phil. at 761-62 ("But although the survivorship agreement is per se not contrary to law, its operation or effect may be violative of the law. For instance, if it be shown in a given case that such agreement is a mere cloak to hide an inofficious donation, to transfer property in fraud of creditors, or to defeat the legitime of a forced heir, it may be assailed and annulled upon such grounds. No such vice has been imputed and established against the agreement involved in this case...There is no demonstration here that the survivorship agreement had been executed for such unlawful purposes, or, as held by the respondent court, in order to frustrate our laws on wills, donations, and conjugal partnership.").

62. Commissioner of Internal Revenue v. Concepcion, 22 SCRA 1058 (1968).

63. Concepcion, as ancillary administrator of the estate of Mitchell-Roberts, sought a refund of the estate and inheritance taxes paid on 50 shares of stock of Edward J. Nell Company issued in the names of both spouses as joint tenants with full rights of survivorship. Assessment was made by the Commissioner on the ground that there was a transmission to the husband of one-half share thereof upon the death of the wife, the above shares being conjugal property. Respondents maintained on the other hand that there was no transmission of property since under English law, ownership of all property acquired during the marriage vests in the husband. Moreover, the shares of stock were issued to the spouses *as joint tenants with full rights of survivorship and not as tenants in common*. Unfortunately, the court did not bother to resolve this issue, but curiously, the Commissioner's ruling seems to be in direct conflict with the court's previous rulings in Macam and Rivera.

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III. IMPLICATIONS

A. Defect in Form

The will substitutes differ from the ordinary *last will and testament* in three main ways.[66] First, most will substitutes, though not all, are asset-specific. Each deals with a single type of property, be it life insurance proceeds, a bank balance, mutual fund shares, etc. The will substitute is similar to a specific devise in that it disposes of specific, identifiable property—an account or security, or rights under a life insurance policy or pension plan. Most will substitutes involve direct payments of cash or transfers of property either to named beneficiaries or to a class consisting of the owner's children or descendants who survive the deceased owner. The asset-specific character of a will substitute sets the underlying property apart from the owner's general assets.

Second, the formal requirements of wills do not govern will substitutes and, as such, need not be complied with. As inheritance law stands on ceremony, in order to effectively create a will, the testator must not only express his substantive intentions but also observe a number of procedural niceties for due execution.[67] Since most will substitutes are commercial documents prepared by financial institutions, they will never pass as holographic wills.[68] Neither can they be considered as notarial wills with stringent requirements.[69]

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marriage vests in the husband. Moreover, the shares of stock were issued to the spouses *as joint tenants with full rights of survivorship and not as tenants in common*. Unfortunately, the court did not bother to resolve this issue, but curiously, the Commissioner's ruling seems to be in direct conflict with the court's previous rulings in Macam and Rivera.

66. Of these differences, only the last one, probate avoidance is a significant advantage that transferors might consciously seek.

67. Langbein, *supra* note 3, at 1115.

68. CIVIL CODE OF THE PHILIPPINES, art. 810 ("A person may execute a holographic will which must be entirely written, dated, and signed by the hand of the testator himself. It is subject to no other form, and may be made in or out of the Philippines, and need not be witnessed.").

69. CIVIL CODE OF THE PHILIPPINES, art. 805-6. The full provisions are:

> Art. 806. Every will, other than a holographic will, must be subscribed at the end thereof by the testator himself or by the testator's name written by some other person in his presence, and by his express direction, and attested and subscribed by three or

The primordial object of the solemnities surrounding the execution of wills is to close the door against bad faith and fraud, to avoid substitution of wills and to guaranty their truth and authenticity.[70] They serve to provide the probate court with clear evidence of the authenticity and substance of the estate plan submitted to it as the testator's. Given that the testator is unavailable to verify those facts personally, the probate court needs a reliable alternative and a witnessed, signed writing meets that end.

United States commentators believe that states require testators to comply with Statutes of Wills for four principal reasons. First, by requiring a level of ceremony, Statutes of Wills serve a ritual, or cautionary function by impressing upon the testator the significance of his statements. This permits the court to determine that the testator intended the court to give such statements legal effect. Second, it serves an evidentiary function by preserving evidence so that the court can be confident it has reliable information regarding the testator's intent. Third, these formalities serve a protective function by safeguarding the testator, at the time of executing the will, from undue influence and fraud. Finally, the Statutes of Wills serve a channeling function by requiring a testator to use similar forms, features, and

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more credible witnesses in the presence of the testator and of one another.

The testator or the person requested by him to write his name and the instrumental witnesses of the will, shall also sign, as aforesaid, each and every page thereof, except the last, on the left margin, and all the pages shall be numbered correlatively in letters placed on the upper part of each page.

The attestation shall state the number of pages used upon which the will is written, and the fact that the testator signed the will and every page thereof, or caused some other person to write his name, under his express direction, in the presence of the instrumental witnesses, and that the latter witnessed and signed the will and all the pages thereof in the presence of the testator and of one another. If the attestation clause is in a language not known to the witnesses, it shall be interpreted to them.

Art. 806. Every will must be acknowledged before a notary public by the testator and the witnesses. The notary public shall not be required to retain a copy of the will, or file another with the Office of the Clerk of Court.

70. ARTURO TOLENTINO, CIVIL CODE OF THE PHILIPPINES VOL. III, 147 (2001).

procedures which provides him with greater assurance that the court will carry out his wishes.[71]

It is quite interesting that will-like transfers earn the approval of courts, when any slight deviation from the stringent requirements of the law as regards form, negate such wills almost all of the time. That is why United States courts have strained to find a justification offering various theories to differentiate one from the other and justify their designation as non-testamentary.

Essentially there are three theories: (1) gift, (2) trust and (3) contract. As with the first theory, the essential difference between a will and a gift is that the latter is a lifetime transfer, ordinarily effected by present delivery of the property, whereas the former transfers property only on the transferor's death. The proper terms commonly used to denote this distinction are *inter vivos*[72] and *mortis causa*,[73] as stated in the New Civil Code.[74]

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71. JESSE DUKEMINIER & STANLEY M. JOHANSON, WILLS, TRUSTS, AND ESTATES 36 (5th ed. 1995).

72. Examples of *inter vivos* donations are: (a) a donation where the causes of revocation have been specified (Zapanta v. Posadas, 52 Phil. 557 (1928)); (b) donation where the donor reserved for himself a lifetime usufruct of the property, for if he were still the owner there would be no need of said reservation (Balaqui v. Dongso, 53 Phil. 653 (1929)); (c) a donation where the donor warrants the title to the thing which he is donating (Balaqui v. Dongso, 53 Phil. 653 (1929)), there would be no need of warranty were he not already transferring the title; (d) where the donor immediately transferred the ownership, possession and administration of the property to the donee, but stipulated that the right of the donee to harvest and alienate the fruits would begin only after the donor's death (Guzman v. Ibea, 67 Phil. 633 (1939)); (e) where the donor stated that while he is alive he would not dispose of the property or take away the land "because I am reserving it to him, (the donee) upon my death" (Cuevas v. Cuevas, 98 Phil. 68 (1955)).

73. Examples of donations *mortis causa* on the other hand are: (a) where the donor has reserved (expressly or impliedly) the option to revoke the donation at any time before death, even without the consent of the donee (Bautista v. Sabiniano, 92 Phil. 244 (1952)); (b) where the donation will be void if the transferee dies ahead of the transferor (Heirs of Bonsato v. Court of Appeals, 95 Phil. 481 (1954)); (c) if before the donor's death, it is revocable at his will (Heirs of Bonsato v. Court of Appeals, 95 Phil. 481 (1954)); (d) if the donor retains full or naked ownership and control over the property while he is still alive (Heirs of Bonsato v. Court of Appeals, 95 Phil. 481 (1954)); (e) if what was in the meantime transferred to the donee was merely the administration of the property (Cariño v. Abaya, 70 Phil. 182 (1940).

74. CIVIL CODE OF THE PHILIPPINES, art. 728-31 which provide in full:

In the Philippines, joint bank accounts, P.O.D. accounts, and *Totten trusts* are more apt to be classified as *mortis causa* donations, since ownership and control remains with the donor and entitlement of the donee or the right to be paid is conditioned upon the death of the former.

The ambulatory character of a will is accepted as the distinguishing feature of testamentary disposition. The law looks to the time that the transferor intended to create an interest or property right in the transferee, the degree of control which the former retains over the property carries great weight in the transferor's intention as well. That is why it is no surprise why the Philippine Supreme Court did not even bother to mention this *mortis causa/ inter vivos* distinction in the cases that involved survivorship agreements. It is here where Philippine case law and United States case law reach a divergence, as some courts in the latter continue to validate joint bank deposits and *Totten trusts* as they are considered *gifts in praesenti*.

The leading case exemplifying this mode of analysis is *Farkas v. Williams*,[75] decided by the Illinois Supreme Court in 1955. Farkas signed four identical fill-in-the-blank declarations of trust supplied by an investment company in connection with his purchase from the company of four blocks of mutual fund shares. He filled in the name of Williams, a faithful employee, as the beneficiary of each trust. The standard form terms reserved to Farkas the right to revoke the trust, to change beneficiaries, and to receive the trust income for life. If the beneficiary predeceases the testator, the trusts would automatically be revoked. Sale of some or all of the shares would

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> Art. 728. Donations which are to take effect upon the death of the donor partake of the nature of testamentary provisions, and shall be governed by the rules established in the Title on Succession.
>
> Art. 729. When the donor intends that the donation shall take effect during the lifetime of the donor, though the property shall not be delivered till after the donor's death, this shall be a donation *inter vivos*. The fruits of the property from the time of the acceptance of the donation, shall pertain to the donee, unless the donor provides otherwise.
>
> Art. 730. The fixing of an event or the imposition of a suspensive condition, which may take place beyond the natural expectation of life of the donor, does not destroy the nature of the act as a donation inter vivos, unless a contrary intention appears.
>
> Art. 731. When a person donates something, subject to the resolutory condition of the donor's survival, there is a donation *inter vivos*.

75. Farkas v. Williams, 5 Ill. 2d 417, 125 N.E.2d 600 (1955).

operate as revocation *pro tanto*. The declarations were not attested and hence did not conform to the requirements of the local Wills Act. Farkas died intestate, and his heirs claimed the mutual fund shares for the probate estate. The lower court ruled in their favor as the beneficiary had no enforceable interest during the trustor's lifetime as the purported trusts were attempted wills that failed for want of compliance with the Wills Act formalities.

The Supreme Court however reversed, concluding that the trusts had created a present interest in the beneficiary. While it is difficult to name this interest the Court pointed approvingly to a label used in the first Restatement of Trusts—*contingent equitable interest in remainder*. This pertains to the only interest that, according to the court, passed *inter vivos* to the beneficiary—one in a potential lawsuit. This is the right to sue the trustee for a breach of some fiduciary duty that impaired the beneficiary's remainder interest. Acknowledging that the beneficiary would never sue during the trustee's life because the trustee could revoke and defeat the claim, the court maintained that the beneficiary could wait for the trustee to die and then sue his estate for the breach of fiduciary duty.[76]

Courts have used such doctrinal ruses to validate not only the revocable *inter vivos* trust, but the other will substitutes as well. A transfer by life insurance policy or by pension plan is not void for violation of the solemnities of wills as the beneficiary's interest is *vested* during the transferor's lifetime. The fact that the transferor may freely revoke the beneficiary's interest makes such interest "vested subject to defeasance." It is at this juncture that one may say that no difference lies between revocable and ambulatory interest created by a will, and a vested but defeasible interest in life insurance or pension proceeds, except for the form of words. Despite this reality of course, judicial fiat of common law courts have held otherwise.

The second theory is known as the trust theory, which in essence is similar to the gift theory. The only difference is that in the case of a gift the thing itself passes to the donee, while in the case of a trust the actual, beneficial, or equitable interest passes to the *cestui que trust*, while the legal title is transferred to a third person or it is retained by the person creating it to hold for the purpose of the trust. Possession and control in the latter remain with the trustee, but a gift of the equitable or beneficial title must be as complete and effectual in the case of a trust as in the gift of the thing itself in a gift *inter vivos*.

In some cases the title of the donee, which could not be sustained upon the ground that the deposit in the joint names of the owner and the donee constituted a valid gift, has been upheld on the theory that the owner was

76. Langbein, *supra* note 3, at 1126-1128.

holding the deposit in trust for his co-depositor, the making of the joint deposit being held to constitute proof of an intention to create a trust.

A joint deposit in the name of the depositor and another, though coupled with a statement that the survivor of them shall take the deposit, is not, of itself, a sufficient declaration of trust. In order to create a valid trust, the depositor or the creator of the trust, either in writing or by parole must show that property is held in trust for the purpose named; where there is no such clear declaration, the right of the survivor cannot be sustained on the trust theory. It is not necessary, however, to use the words *in trust*, nor is a reservation of the right to receive the interest from the property for the donor's life inconsistent with the trust. Indeed, a power of revocation is entirely consistent with the trust, as the trust is enforceable in favor of the survivor. However, in the absence of an express reservation of the power to revoke, and where such a trust is completely and effectually created, the trust is beyond revocation by the simple act or declaration of its creator.

As was stated, the question of whether a savings account deposit in the name of the depositor in trust for himself and another as joint owners creates a trust vesting the fund in the survivor depends upon the intention of the depositor at the time of such entry in the bankbook; the entry itself indicates an intent to create a trust, but the entry may be explained and the intention it indicates may be rebutted.

Be that as it may, whether the transfer is by way of gift or by trust, both are inadequate to justify or validate will substitutes because title and control is still held, in varying degrees depending on type of transfer used, by the transferor. That is why the favored theory by the Philippine Supreme Court is that of the contract which has been espoused in the cases of *Macam*, *Rivera*, and *Vitug*.

As with the third theory, by an aleatory contract, one of the parties or both, reciprocally bind themselves to give or to do something in consideration of what the other shall give or do upon the happening of an event which is uncertain, or which is to occur at an indeterminate time.[77]

Aleatory contracts involve a future event, which is uncertain to happen like a condition or though certain to arrive, its date is uncertain, like a term. It is different from a contract with a suspensive condition, because in the former, whether or not the event happens, the contract remains and only the effects and extent of profit and losses are determined whereas in the latter if the condition does not happen, the obligation never becomes arises.

77. CIVIL CODE OF THE PHILIPPINES, art. 2010.

The object of an aleatory contract is either an obligation to give or to do. It may bind only one (unilateral) or both (reciprocal) contracting parties. Aleatory contracts may be simple or double. *Simple,* if one of the contracting parties is exposed to a risk for the benefit of the other in consideration of a certain sum which is the price of the contract. *Double,* when the two contracting parties' object is the equivalent of what the other would give or do in reference to an uncertain event or to an indeterminate time for its fulfillment. In either case, the indispensable common element is that of risk which consist either in the uncertainty of the event happening, or an event surely to happen, like death, but certain as to the time of its happening.

Two classes of aleatory contracts are recognized: (1) those that depend on an uncertain event, such as insurance,[78] gambling and betting,[79] and (2) those that are subordinated to an event certain but in determine as to time, like life annuity.[80] It has been held in Rivera and Vitug that a survivorship agreement and a reciprocal assignment of property conditioned upon death as seen in Macam were aleatory contracts of the first kind. The Court gave no elaborate explanation why it concluded as such but only tersely stated that it is an aleatory contract supported by a lawful consideration—the mutual agreement of the joint depositors permitting either of them to withdraw the whole deposit during their lifetime and transferring the balance to the survivor upon the death of one of them.

Although not designated as an aleatory contract, some United States courts have espoused the same rationale in validating will substitutes. For example, if the balance of the deposit is transferred to B upon A's death, such transfer is not an invalid testamentary disposition for failure to comply with requirements for a will, but rather a contractual payment triggered by A's death. The bank is obligated by the contract to pay the survivor.

The crux of the issue however is the question of who really owns the property prior to the death of one of the parties to the contract. It is probable that A is the sole contributor to the account, and the only reason for the account is to enable the other to pay A's bills or for A's benefit in other respects. In this instance, control and entitlement to the fund remains with A and transfer at death cannot be justified simply by filling up a survivorship agreement. Transfer must be made only through the system of succession. It is probable that both A and B contributed equally to the fund, or maybe 60-40 or 70-30, regardless of the actual contribution, however, two facts are clear, first, each may draw on the account beyond his actual

78. *Id.* art. 2011.

79. *Id.* art. 2013.

80. *Id.* art. 2021 *et seq.*

contribution and even deplete it thus there would be no balance to transfer upon the death of the other, and second, the balance if there be any, shall be transferred to the survivor. Following the reasoning of the Supreme Court, both parties bind themselves to give the other his contribution to the general fund in consideration of the other's contribution, upon the happening of an event, that is, death of one and survivorship of the other. For example, if A gave 30 percent of the fund he will acquire B's 70 percent for as long as he predeceases the latter. In this regard, it is similar to gambling, because there is risk of loss yet there is also the chance to gain.

B. Probate Avoidance

The distinctions between will substitutes and notarial wills are that the former is asset-specific, and that they are not governed by the strict formal requirements of the latter. The third difference between notartial wills and will substitutes is really an effect or consequence of the different treatment by the courts with regard to the two instruments. Property that passes through a will substitute avoids probate. A financial intermediary ordinarily takes the place of the probate court in effecting the transfer.

What makes the will substitute attractive is this opportunity to avoid probate or administration of the decedent's estate. For example, when a joint deposit account is executed, the time and expense of judicial administration is avoided because title and ownership to the fund is immediately vested in the survivor upon the death of the co-depositor. However, the value of avoiding probate is easily overstated, especially in this example, as probate is not really avoided since the other properties of the estate would still have to be probated, save of course if the only property of the estate is the savings account. Nevertheless, a partial or total avoidance of probate seems to be the motive which fuels what Langbein calls a *revolution.*

Why avoid probate in the first place? The impression some people seem to have is that probate is an archaic, rigid, time-consuming, and very expensive procedure, requiring unending paperwork that seems to serve no useful purpose. Perhaps, the criticisms of the probate process are justified. It is not uncommon in the Philippines for probate administration to take a long time, maybe even several years, a decade or so, and costs running up to millions of pesos which eventually deplete the estate.

Although the Rules of Court provide for an informal probate administration, these are limited alternatives and not too encompassing. The Rules of Court includes provisions for extra-judicial settlement and summary settlement of estates of small value, but the former can only be availed of if the decedent left no will and no debts and the latter is only for intestate or testate estates whose gross value does not exceed ten thousand pesos.

Probate is defined as a special proceeding to establish the validity of a will. The purpose of probate is to prove before some competent or tribunal vested with authority for that purpose that the instrument which is offered for probate is the last will and testament of the testator, that it has been executed in accordance with the formalities prescribed by law, and that the testator had the necessary testamentary capacity at the time of the execution of the will.[81] But this is an incomplete definition, since probate is really a process where the allowance or disallowance of the will based on its intrinsic validity is only a part thereof. Probate serves the ends of assuring that the decedent's creditors are paid, the government receives its taxes, and the intended beneficiaries are properly identified and receive what they are entitled to. That is why it includes the determination of extrinsic validity of the instrument, the appointment of the personal representative to manage the estate and the submission of his accounts to the courts.

Firmly rooted in the English history of the law of succession is the notion that the rights of creditors should be protected. As handling the claims of creditors against a decedent's estate became indispensable. George Crabb, in his history of English Law, noted that during the feudal period, a debtor could not dispose of his property at death without the consent of his heirs because an heir of legal age was bound to pay the deficiency out of his inheritance.[82]

Most heirs try to circumvent formal administration of the estate, not realizing that there is an added convenience in having one personal representative who can coordinate the payment of debts, expenses and taxes; in addition the benefit of court supervision, is added protection to deter fraud and abuse. And if legal disputes arise, there is a forum for their resolution.[83]

Following the Supreme Court's rulings in the cases previously discussed, assets of the decedent which are ordinarily *included* in the representative's

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81. MORAN, COMMENTS ON THE RULES OF COURT, VOL. III, 510 (1997) (citing Heirs of Marcelo Macmac v. Macmac, CV-69308 (1986)).

82. FRED ROTHMAN, ATTEMPT TO TRACE THE RISE, PROGRESS, AND SUCCESSIVE CHANGES, OF THE COMMON LAW; FROM THE EARLIEST PERIOD TO THE PRESENT TIME 98 (1987).

83. REVISED RULES OF COURT, Rule 83 §1 ("*Inventory and appraisal to be returned within three months*. - When three (3) months after his appointment every executor or administrator shall return to the court a true inventory and appraisal of all the real and personal estate of the deceased which has come into his possession or knowledge. In the appraisement of such estate, the court may order one or more of the inheritance tax appraisers to give his or their assistance.").

inventory would be *exempted* because they are valid aleatory contracts. While jurisprudence on the matter is scarce and as the properties covered are not merely limited to joint bank deposits, stocks and bonds (the Court has allowed a house and lot, furniture and fixtures, and even a car to be exempt from such requirements), there is no reason why all other types of property should not be allowed exemption provided what is involved is an aleatory contract, as determined by the Court. By avoiding probate, an entire process *designed to protect* will be put to naught and prejudice the heirs, creditors and the State.

Another point to consider when dealing with non-probate property is the statute of non-claims. Many people want to avoid probate as if it were the plague, but they fail to consider that when property is not probated, valid creditors still have the right to be paid. Some may argue that the creditor will have a difficult time finding who inherited the deceased debtor's property, and even if the same is found, the creditor may opt not to file a lawsuit, as it is not worth the time and expense. However, if one wants to take advantage of probate's creditor cut-off, then the property must pass through probate. If not, the reality is that there is a good chance the creditor could still sue even after the probate claim cut-off and try to collect from the property that did not go through probate.

Probate administration allows the personal representative to determine with *finality* all debts of the decedent and claims against the estate through the availability of a shortened statute of limitations on creditor claims referred to as the statute of non-claims. A decedent's creditors have a limited period of time to make claims against the estate. After the claims period, creditors are barred from making further claims against the decedent's estate.[84]

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84. RULES OF COURT, Rule 86 §§1, 2 & 5. The rules provide:

> Sec, 1. *Notice to creditors to be issued by court.* - Immediately after granting letters testamentary or of administration, the court shall issue a notice requiring all persons having money claims against the decedent to file them in the office of the clerk of said court.
> Sec. 2. *Time within which claims shall be filed.* - In the notice provided in the preceding section, the court shall state the time for the filing of claims against the estate, which shall not be more than twelve (12) nor less than six (6) months after the date of the first publication of the notice.
>
> x x x
>
> Sec. 5. *Claims which must be filed under the notice.* - If not filed, barred; exceptions. All claims for money against the decedent, arising from contract, express or implied, whether the same be due,

If probate is avoided by the use of a living trust, or other non-probate means, in theory, the transferee gives up the benefit of the statute of non-claims and would have to wait an extended period of time to effectively close the door to the creditors. However, it may be argued that the subsequent transfer may be beyond the reach of the creditors anyway, for as long as it can be shown that there was no intent to defraud the creditors. In fact, the burden regarding this matter shifts its weight to the creditors as they are the ones who must prove the existence of fraud in such transfers.

One may argue that a creditor is not without remedy if property is transferred without the benefit of probate, which will afford the creditor no notice of the death of the debtor. For example, a creditor may attempt to reach a revocable trust upon the death of the deceased trustor by asserting the transfer into the trust to be a fraudulent transfer, intended to defeat his rights. The New Civil Code provides this remedy known as *accion pauliana.*[85] Notwithstanding the fact that the creditor is not a party to the contract intended to defraud him, he is given legal personality to terminate the contract with the remedy of rescission.[86]

However, courts would analyze *will substitutes* as lifetime transfers and grant relief only if the transfer were fraudulent as to creditors when made, which is quite easy to prove if the transfers were mere deathbed transactions but difficult if they were entered into years prior to the decedent's death. In *Bobis v. Provincial Sheriff of Camarines Norte,*[87] the Court provided the requirements that the plaintiff must show in order to rescind the contract.

> The rule, however, is that fraud is not presumed. As fraud is criminal in nature, it must be proved by clear preponderance of evidence. In order that a contract may be rescinded as in fraud of creditors, it is essential that it be shown that both contracting parties have acted maliciously and with fraud and for the purpose of prejudicing said creditors, and that the latter are deprived by the transaction of all means by which they may effect collection of their claims. All these circumstances must concur in a given case. The presence of only one of them is not enough…Besides, Alfonso Ortega knew of such sale and did nothing to have it annulled as in fraud of

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> not due, or contingent, all claims for funeral expenses and expenses for the last sickness of the decedent, and judgment for money against the decedent, must be filed within the time limited in the notice; otherwise they are barred forever…

85. CIVIL CODE OF THE PHILIPPINES, art. 1313 ("Creditors are protected in cases of contracts intended to defraud them.").

86. *Id.* at art. 1381 ("The following contracts are rescissible: (3) Those undertaken in fraud of creditors when the latter cannot in any other manner collect the claims due them;").

87. Bobis v. Provincial Sheriff of Camarines Norte, 121 SCRA 28 (1983).

> creditors. Now did he cause a cautionary notice to be inscribed in the certificate of title to protect his interests. Moreover, the sale was not fictitious, designed to escape payment of the obligation to Alfonso Ortega. The tenacity by which Emilia Guadalupe had clung to her property to the extent of undergoing imprisonment is indicative of their good faith.[88]

Moreover, even if applicable, recovery will only be to the extent necessary to pay unsecured debts but not expenses of administration, statutory allowances or other items that take priority over distributions to heirs and devisees.

Even in the United States, where statutes have been enacted to protect the creditors specifically against will substitutes, there is still much confusion. There is no established procedure under which creditors may seek to enforce the rights they have over non-probate property at the death of the debtor as there is no fixed time limit under which those claims will be cut-off. Take for example joint tenancies. The rule in American jurisprudence is:

> [a]n estate in joint tenancy is one held by two or more persons jointly, with equal rights to share in its enjoyment during their lives, and having as its distinguishing feature the right of survivorship, by virtue of which the entire estate, upon the death of a joint tenant, goes to the survivor, or, in the case of more than two joint tenants, to the survivors, and so on to the last survivor, *free and exempt from all charges made by his deceased cotenant or cotenants.*[89]

The same is true for revocable trusts. Under the typical revocable trust arrangement, the grantor reserves the right to income for life and a power to revoke the trust. In most states, the courts follow the Restatement of Trusts and hold that a power to revoke is only a *power*, not *property*, and therefore creditors cannot reach the principal of a revocable trust either during the grantor's life or after his death. Many states have modified this rule by statute, thus allowing creditors of the grantor a revocable trust to recover against the trust assets. However, most of these statutes do not address the issue of whether the creditors can reach the trust assets after the death of the grantor, to the effect that these statutes have been construed as applying only during the life of the grantor and not after his death, when the power of revocation has expired.[90]

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88. *Id.* at 38-39.

89. Thomas R. Andrews, *Creditors' Rights Against Non-probate Assets in Washington: Time for Reform,* 65 WASH. L. REV. 73 (1990). (*emphasis supplied*)

90. *See* Clifton B. Kruse, Jr., *Revocable Trusts: Creditors' Rights After Settlor-Debtor's Death,* 7 PROB. & PROP. (Nov/Dec. 1993).

Another area of concern is the issue of *community obligation*, which is one entered into on behalf of or for the benefit of the community of husband and wife. Debts incurred by a spouse during marriage are presumed to be community debts. All community property, regardless of which spouse incurred the obligation, are ordinarily held to be subject to community debts incurred by the couple during marriage. This liability survives the death of the first spouse, and in order to dispose of community liabilities, the whole of the community property is subject to probate in the estate of the first to die. Most joint deposit accounts and life insurance contracts are entered into by spouses to benefit whoever survives between them, thus the proceeds thereof no longer form part of the community property and will automatically be considered as separate property of the surviving spouse and will no longer be included in the inventory of the community or conjugal property. The onus is now on the creditor to show that the transfer was one tainted with fraud.

Compulsory heirs are not quite in the same boat with respect to their diminished legitimes. The system of legitimes is a limitation upon the freedom of the testator to dispose of his property. Its purpose is to protect those heirs from the testator's unjust ire or weakness or thoughtlessness.

Although the system of legitimes limits the testator's right to dispose of property *mortis causa,* the limitation upon acts *inter vivos* is confined to dispositions by gratuitous title. When the disposition is for valuable consideration, there is no diminution of the estate, but merely a substitution of values. The mere fact of being a father, child or spouse, however, does not completely incapacitate a person to dispose of his property gratuitously. Man is not only a member of a family; he is likewise a member of society, and as such can entertain, not only family affections, but also fully legitimate affection and gratitude for friends, associates and fellowmen. His hands should not therefore be absolutely restrained from disposing of property according to the dictates of generosity. Neither should he be allowed complete freedom, because such freedom might be converted into a real despotism or be swayed by momentary passions which may leave those related to him most closely by blood and family ties in a state of misery. Hence, the division of a person's estate into legitimes, of which he has no control, and free portion, of which he has absolute disposition in favor of persons capacitated to succeed.[91]

The use of will substitutes do not amount to a burden on one's legitime, as the Supreme Court believes that they are not dispositions by gratuitous title, they are aleatory contracts. However, where is the valuable consideration? How can it be a mere substitution in values when the

91. TOLENTINO, *supra* note 68, at 248.

survivor takes all and the heirs are left with nothing? What remedies are available to them? Not being creditors of the decedents but merely possessors of rights *inchoate* they are not given the same legal recourse of *accion pauliana* given to the creditors. Not being a donation *inter vivos* nor *mortis causa* dispositions but aleatory contracts, transfers through survivorship agreements and the like are not subject to reduction, revocation or even collation.

Another complication that probate avoidance brings, on the part of the State, is the possibility that these types of dispositions tend to reduce the amount of estate taxes payable. In the United States, countless stories exist about families being forced to sell cherished assets in order to cover the high cost of their federal estate taxes.[92] This is why people resort to clever yet legal means to avoid taxes. Death and taxes, one can never avoid them really, one can only cheat them.

Estate tax is the tax on the right to transmit property at death and on certain transfers which are made by the statute the equivalent of testamentary dispositions; it is measured by the value of the property.[93] Inheritance tax is a tax on the privilege of inheriting the property of a person upon his death. It has also been defined as a tax imposed on the legal right or privilege to succeed to, receive or take property by or under a will, intestacy law, or deed, grant or gift becoming operative at or after death. It is also referred to as a *succession tax* or *duty*, or *legacy tax*.[94] However, inheritance tax is no longer imposed under the Tax Code as the provisions pertaining to this have been repealed. The principal disadvantage of the latter is on the practical administrative side, and arises particularly where the will of the testator provides for contingent future interests, with the result that the persons who will take and the amount they will receive may remain uncertain for many years after the decedent's death. This leads to difficulties of evaluation and collection and loss of revenue.[95]

Under the Tax Code, the gross estate of a decedent for purposes of estate taxation is not limited to and may exceed the actual value of his assets at the time of his death. Subject to inclusion in the taxable estate are: (1)

92. *See e.g.* Seth R. Kaplan & Paul S. Labiner, *Qualified Retirement Plans, Trusts and Life Insurance: The Formula for Creative Estate Planning,* 69 FLA. B.J. 33 (1995) (A foreign art investor who purchased Van Gogh's Portrait of Dr. Gochet for $82.5 million and Renoir's Le Molin de la Galette for $78.1 million boasted in a 1991 press conference that the paintings should be cremated with his body when he dies, so that his heirs could avoid paying his country's inheritance taxes.).

93. ALEXANDER'S FEDERAL TAX HANDBOOK 561 (1956).

94. Lorenzo v. Posadas, 64 Phil. 353 (1937).

95. PAUL, FEDERAL ESTATE AND GIFT TAXATION VOL. I 20 (1942).

interest in property possessed—the value of any interest in property which at the time of decedent's death are in his actual or constructive possession or enjoyment; (2) interest in property owned—the value of any interest in property which the decedent owned at the time of his death; and (3) property of interest transferred—in addition, for the purpose of preventing tax avoidance, the value of transfers of property or interest in property made by the decedent during his lifetime which partake of the nature of testamentary dispositions. These transfers are in effect considered by law as a farce and are, therefore, disregarded.

It is clear then, that where the decedent had, before his death, relinquished his interest in property, he could not be deemed to have transmitted any interest in such property at his death. Why then, do survivorship agreements and other will-like, testamentary-type dispositions end up being tax-free transactions? Is it because the decedent no longer owns or possesses any interest in the property at the time of his death? Surely, a co-depositor in a joint bank account still maintains an interest in the shared account even after his death. For example, if A shares a joint account with B, and the former signs a check on June 1, then unfortunately meets his demise on June 2, even if the check is presented for payment only on June 3, the check would still be honored. Yet, because of the *winner-take-all* provision in the survivorship agreement and the Supreme Court reasoning that such is a valid aleatory contract, A is deemed to have lost all interest in the account at the time of his death. By stating that it is an aleatory contract, the Supreme Court seems to infer that A and B are actually wagering. A and B would open an account, contribute to it, withdraw as much as each would like and then whoever dies first would lose not only his life but also his share in the fund because he loses in the wager. The transfer of the fund in B's sole name is not to be considered a disposition *mortis causa* but an obligation to give the balance to the winner of the wager.

Revenue laws are carefully crafted by legislators to make sure loopholes are plugged, that all possible scenarios are taxed accordingly, and taxes, once assessed, are collected efficiently. Take for instance estate taxes, to ensure payment thereof, the Tax Code imposes certain duties on certain offices or officers and even on the debtors of the deceased. For example: the estate tax should be paid by the executor or administrator before delivery to any beneficiary his distributive share of the estate,[96] the judge cannot authorize the executor or judicial administrator to deliver a distributive share to any party interested in the estate unless a certification from the Commissioner that the estate tax has been paid is shown,[97] if a bank has knowledge of the

96. NATIONAL INTERNAL REVENUE CODE, § 91(c).

97. *Id.* at § 94.

death of a person who maintained a bank deposit account alone or jointly with another, it shall not allow any withdrawal from the said joint deposit account unless the Commissioner has certified that the estate taxes imposed thereon have been paid. For this purpose, all withdrawal slips shall contain a statement to the effect that all of the joint depositors are still alive at the time of withdrawal by any one of the joint depositors and such statement shall be under oath by the said depositor.[98]

If the proliferation of *will substitutes* continues unabated, it will undermine the integrity of the probate system and would weaken the laws on succession. Sooner or later it would mutate into different variants, covering more and more types of properties which would leave little, if any at all, to satisfy those due to the creditors and the heirs. Why bother making a will with all its stringent and confusing rules, when one can place most of his assets in bank accounts, trusts and other forms of aleatory contracts? In doing so, the "testator" or transferor, has not only avoided his creditors, diminished his taxes but could diminish the legitime of an unfavored heir without tacitly disinheriting him.

Problems associated with probate administration are not caused by the probate process itself, but are indicative of problems with people, or the property in the estate. Will contests and other disagreements among estate beneficiaries can significantly prolong estate administration. Similarly, a decedent who leaves assets in disarray can greatly hinder the estate representative's ability to effectively catalogue the assets and satisfy estate obligations so that distribution can take place efficiently.

The solution is to speed up the process, not condone its circumvention. The executive, legislative and judicial branches of the government must recognize, in enforcing, creating and interpreting the law, the deeper need that makes the public susceptible to the siren song of will substitutes—the need to transmit property at death easily, expeditiously, and inexpensively. There is a need to appropriate safeguards consistent with the objectives of the probate system and laws on succession, and to strengthen such safeguards as well.

IV. CONCLUSION

Although not without problems, the probate system does serve several functions, including the implementation of public policies. It is generally recognized that the underlying purpose of administering a decedent's estate is to collect the assets, pay those who have claims against the decedent and the assets, and transmit possession with unencumbered title to the next owner as

98. *Id.* at § 97, ¶ 2.

quickly and as inexpensively as possible. However, not everything goes as well and as quickly as planned, that is why circumvention of the probate court by the use of legal devices such as will substitutes are used as an alternative to the administration of estates.

There are a myriad of motives why people choose will substitutes, some may have consciously sought its non-testamentary character, while others may have not even known about it. But whatever their reasons, the State must step in and decree that they should follow the formalities of notarial wills and such instrument must be offered in probate.

The use of will substitutes, such as joint bank accounts with right of survivorship, has been validated by the Supreme Court, nevertheless structural consistency of the law which means applying the same legal principles to analogous situations is necessary to preserve the legitimacy of law, particularly the laws on succession and probate administration. When people enter into will-like dispositions, they are not breaking the law; but if they are continuously allowed to do so, people will be encouraged to discard rules on formalities and requirements of wills and probate, which are precisely for the protection of all parties involved: the decedent, the heirs, the creditors and the State.

The non-probate revolution is a benign and irreversible development. Free market competitors have relegated probate to the periphery of the succession process. This Article has undertaken to explain how the business practice of financial intermediaries has rendered probate so often superfluous. But legal doctrine has not caught up with this great transformation in the practice of succession. Courts have dressed up the will substitutes as lifetime transfers in order to avoid conflict with the probate monopoly theory of wealth transmission on death. This theory is fundamentally mistaken and should be discarded. The law would function better if it admitted that will substitutes are simply *wills*. The inconsistent treatment of identical interpretive questions raised by wills and will substitutes is often linked to the mischaracterization of will substitutes as lifetime transfers. The law of wills has reached sound solutions to these interpretive questions, and the Author has urged that these solutions should extend presumptively to the will-like transfers of the non-probate system. The result would be a unified law of succession.