

DIVISION OF EXTRAORDINARY INCOME BETWEEN LIFE TENANT AND REMAINDER-MAN WHEN ESTATES ARE HELD IN TRUST.

Four rules exist for the distribution of extraordinary income when an estate is in trust, with a provision that the income is to be paid to the cestui que trust and the corpus to the remainder-man. These rules have been characterized as the English Rule, Massachusetts Rule, the Pennsylvania or American Rule, and the Kentucky Rule. It might be said that New York has adopted a rule, for ascertaining whether the income goes to the life tenant or to the corpus, which differs to such an extent from the other rules that it might be said to form a fifth rule, but at present it is treated as a modification of the Pennsylvania rule and is considered under that head in this note.

The early English cases held that all extraordinary income whether in stock or cash, and without regard to whether it was earned before or after the testator's death went to the remainder-man and only the ordinary income went to the life tenant. (*In re Borton's case.*)¹ But the later English cases have repudiated this doctrine and have adopted the rule that all cash dividends to the life tenant and all dividends in the forms of shares of stock go to the corpus of the estate.²

The Massachusetts rule as laid down in the early case of *Minot vs. Paine*³ adopts the later English doctrine. The life tenant, when the extraordinary income is in the form of shares of stock, receives the increased income caused by the proportionate increase of the corpus.

If the right to subscribe to the new shares of stock is of value and that right is disposed of by the trustee, the money realized from such sale shall go to the corpus of the estate and the life tenant shall only receive the increased income caused by the proportionate increase of the corpus.⁴ In the case of *Hyde, trustee vs. Holmes*, and others⁵ the court has to deal with a peculiar state of facts. A corporation had declared two cash dividends on stock which the trustee

¹*In re Barton's estate*, L. R. 5 Eq 238.

²*Sproule vs. Bande*, L. R. 29 Q. D. 635.

³*Minot vs. Paine*, 99 Mass. 101; *Leland vs. Haden*, 102 Mass. 545.

⁴*Atkins vs. Albree*, 94 Mass. 359.

⁵*Hyde vs. Holmes*, 198 Mass. 287.

held as part of the assets of the estate. The company also at the same time as the declaring of the dividend, voted, by its directors, to increase the capital stock and gave each stock-holder the privilege of taking a new share of stock for the dividend in cash. The court held that the trustee should take the cash dividend and it should go to the life tenant.

In a still later Massachusetts case the court seems to have modified the rule as laid down in the early cases. In the case of *Gray vs. Hemenway*,⁶ it was held that even though part of the dividend of a corporation was stock in another corporation it was income and would go to the life tenant if the dividend, in stock, represented earning and not increased capitalization.

The United States Court has adopted the rule as laid down by the Massachusetts cases in the case of *Gibbons vs. Mahon*.⁷

The Massachusetts rule has been followed by courts of last resort in Illinois,⁸ Connecticut,⁹ Rhode Island,¹⁰ and Georgia.¹¹

The so-called Pennsylvania or American rule as laid down in *Earp's Appeal*¹² is that all profits which accrue before the testator's death go to the corpus of the estate and all profits which accrue after his death, whether payable in shares of stock or cash, shall go to the life tenant. This decision has been followed in many later Pennsylvania cases.¹³

Under the Pennsylvania doctrine (*Oliver's Estate*¹⁴) it was held that where there was an enormous increase in value of certain lands due to the fact that an ore deposit was discovered on the land, and the land was subsequently sold, that the profit belonged to the life tenant of the part that was sold if the ore deposit was discovered after the testator's death.

The Supreme Courts of Wisconsin,¹⁵ New Hampshire,¹⁶ Minnesota,¹⁷ New Jersey,¹⁸ Tennessee,¹⁹ and Maryland²⁰ follow the Pennsylvania rule.

⁶*Gray vs. Hemenway*, 111 N. E. (Mass.) 549.

⁷*Gibbons vs. Mahon*, 136 U. S. 549.

⁸*De Kohen vs. Alsop*, 205 111 509.

⁹*Bishop vs. Bishop*, 81 Conn. 509; *Boardman vs. Mansfield*, 79 Conn. 634.

¹⁰*Greene vs. Smith*, 17 R. I. 28; *In re Brown*, 14 R. I. 371.

¹¹*Jackson vs. Maddox*, 136 Ga. 31.

¹²*Earp's Appeal*, 28 Pa. 368.

¹³*Smith's Estate*, 140 Pa. 344.

¹⁴*Oliver's Estate*, 136 Pa. 43.

¹⁵*Soehnlein vs. Soehnlein*, 146 Wis. 330.

¹⁶*Holbrook vs. Holbrook*, 74 N. H. 201.

¹⁷*Goodwin vs. McGaughey*, 108 Minn. 248.

¹⁸*Van Dorn vs. Olden*, 19 N. J. Equity, 176.

¹⁹*Pritchell vs. Nashville Trust Co.*, 96 Tenn. 472.

²⁰*Thomas vs. Gregg*, 78 Md. 545.

The rule as laid down by the Kentucky Court, in the case of *Hite vs. Hite*²¹ is that all income whenever earned if declared after testator's death go to the life tenant. In a note in the 50 L.R.A. (n.s.) 510 the statement is made that the chief distinction between the Pennsylvania and the Kentucky rule is that the Kentucky court does not determine when the profit was earned but looks to the time when it was declared—while the time when the profits were made is the controlling feature in the Pennsylvania rule.

The Court of Appeals of New York followed the same rule as is laid down by the Kentucky case for many years, but in the recent case, (*In re Osborne*²²) the court repudiated the Kentucky rule and adopts in a modified form the Pennsylvania rule. The New York rule is peculiar in the manner in which it arrives at whether extraordinary income goes to the corpus of the estate or to the life tenant.

Chase, J. (*in re Osborne* 209 N. Y. 450) loc cit. 485, says, "The intrinsic value of the trust investment is to be ascertained by dividing the capital and the surplus of the corporation existing at the time of the creation of the trust by the number of shares of the corporation then outstanding which gives the value of each share, and that amount must be multiplied by the number of shares held in the trust. The value of the investment represented by the original shares after the dividend has been made is ascertained by exactly the same method. The difference between the two shows the impairment of the corpus of the trust. If the dividend is of money the amount of that difference is to be retained by the trustee as capital and the remainder paid to the life beneficiary. If the dividend is in stock the amount of impairment in money must be divided by the intrinsic value of a share of the new stock, and the quotient gives the number of shares to be retained to make the impairment good—the remaining shares going to the life beneficiary."

In Missouri, the Supreme Court has never directly decided the point so that it remains an open question. But in a recent case in the Circuit Court of St. Louis, (*St. Louis Union Trust Co. vs. Curator's of University of Missouri*,) Jones, J., after a careful review of all the authorities adopts the view of the New York Court of Appeals, as laid down in the case of *In re Osborne*.

²¹*Hite vs. Hite, executor*, 93 Ky. 257.

²²*In re Osborne*, 209 N. Y. 450.