

ST. LOUIS LAW REVIEW

Vol. X

Published by the Undergraduates of the
Washington University School of Law

No. 2.

THE RIGHT TO DIVIDENDS AS BETWEEN LIFE TENANT AND REMAINDERMAN.

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The question as to the conflicting rights of life tenant and remainderman to dividends on corporate stock has repeatedly arisen and has resulted in the expression of widely divergent views and irreconcilable decisions.¹

It would seem that the purpose of the court in any case would be to ascertain and give effect to the intention of the testator or donor, and so it is quite generally agreed that this is what the courts aim to do, so far as practicable.

The difficulty occurs when the will or other instrument creating the life estate and remainder directs the payment of the "earnings" or "income" or "dividends" to the life tenant, and is not sufficiently explicit for the guidance of the court where the distribution by the corporation is of an unusual nature.²

Where the distribution is of the capital of the corporation, as distinguished from surplus or earnings it is clear that it

1. 14 Corpus Juris 829. *Soehnlein v. Soehnlein*, 146 Wis. 320. In re Heaton, 89 Vt. 550.

2. 14 Corpus Juris 829.

goes to the remainderman, i. e., becomes a part of the corpus of the estate. If, for instance, a corporation whose capital is invested in three plants should sell one of them, distribute the proceeds among its shareholders, and reduce its capital stock accordingly, this distribution would go to the remainderman.

Suppose again that the corporation had sold one of its plants at a profit, and then declared a dividend equal to the profit, retaining the balance of the proceeds of sale; should this profit be regarded as capital or income? Since this profit was the result of a mere enhancement in the value of assets representing capital, and not a profit resulting from the operation of the business it would also go to the remainderman.³

On the other hand where a corporation engaged in the business of selling real estate, sold a part of such holdings at a profit and distributed the same it was held that this distribution should go to the life tenant as income.⁴

All courts are agreed that as to cash dividends earned and declared during the term of the life estate, whether ordinary or extraordinary, are income and belong to the life tenant.

It frequently happens, however, that a cash dividend is declared after the vesting of the life term which was earned entirely before that term began, or in other cases was earned partly before and partly after the beginning of the life term. Where it is an ordinary cash dividend the courts hold quite

3. *Kolback v. Clark*, 133 Ia. 215. *Poole v. Union Trust Co.*, 191 Mich. 162. *Holbrook v. Holbrook*, 74 N. H. 201. *Thayer v. Burr*, 201 N. Y. 155. *Müller v. Payne*, 150 Wis. 354.

4. *Washington Co. Hospital Ass'n. v. Hagerstown Trust Co.*, 124 Md.

uniformly that the entire dividend goes to the life tenant as income. The only exception seems to be New Jersey.⁵

When however, the dividend is not the ordinary dividend, but an extraordinary dividend paid in addition to the regular dividend and out of an accumulated surplus, there is a disagreement as to how such dividend is to be distributed as between the life tenant and the remainderman. Here three classes of cases may arise; 1st where the entire extra dividend has been earned before the vesting of the life estate but is declared after such vesting; 2nd where it was earned partly before and partly after the vesting of the life estate, and 3rd where it was earned entirely during the life estate.

As to the third class there can be no question that the dividend would go to the life tenant. But as to the other two classes of cases there is some diversity of opinion.

It would seem that as to the first class the accumulation should in equity belong to the remainderman, but the contrary has been held in at least one case.⁶

In the case of *Foard vs. Safe Deposit & Trust Co.*,⁷ however, it was held that surplus profits accumulated in the life time of the testator, but divided after his death were part of his estate, and not income which would go to the life tenant, and this irrespective of whether the dividend was declared in stock, cash or scrip.

Now this same difference of opinion exists with regard to the second class of cases, namely where the extraordinary

5. *Lang v. Lang*, 57 N. J. Eq. 325.

6. *Richardson v. Richardson*, 75 Me. 570.

7. 122 Md. 476.

dividend declared after the vesting of the life estate was earned partly before and partly after the vesting of that estate, and a discussion of the cases bearing upon this point will explain the reasons for the disagreement with relation to cases in the first class.

Massachusetts rule. The Massachusetts court has adopted the rule that whether a dividend is to be regarded as income, and as such the property of the life tenant, or as capital belonging to the remainderman, is to be determined by the intent of the action of the corporation in declaring the dividend; in other words, if the action of the corporation manifests an intention, so far as it is concerned, no longer to treat the surplus profits as income, but to the extent of the (stock) dividend as part of its permanent capital, the dividend as between the life tenant and remainderman is to be considered as a distribution of capital which would go to the remainderman; but where the effect and intent of the declaration is a permanent separation of its surplus profits to the amount of the dividend, from the capital used in the business, it is to be considered as between such term holders, as income, going to the life tenant.⁸

This view is held by the courts of a number of the States as well as by the Supreme court of the United States, and the English courts.⁹

Under the view held by these courts it follows that regardless of the time the profits out of which they are made

8. 14 Corpus Juris 831.

9. *Leland vs. Hayden*, 102 Mass. 542. *Gibbons vs. McMahon*, 136 U. S. 549. *Smith vs. Dana*, 77 Conn. 543. *DeKoven vs. Alsop*, 25 Ill. 309. *Humphrey vs. Lang*, 169 N. C. 601. *Newport Trust Co. vs. Van Ranselaer*, 32 R. I. 231. *Eisner vs. McComber*, 253 U. S. 180. *Jones vs. Evans*, 1 Chan. 23; 82 L. J. Ch. Div. 12.

accumulate, all stock dividends are to be considered as capital going to the remainderman, and all cash dividends as income going to the life tenant.

The logic of these decisions is briefly this; The directors of a corporation determine what dividends are to be paid, what earnings are to be put aside as surplus, whether the whole or part of the surplus shall be used to expand the business, and in general have the right to decide the policy of the business. Under this view the life tenant could not claim to own a portion of an undivided surplus.

Unless the directors declared a dividend the surplus remains the property of the corporation. If it declares and distributes this surplus as a dividend, then it goes from the corporation to the stockholders; if this dividend is in cash it is clearly a distribution of a portion of the assets of the company. However, if the dividend is purely a stock dividend then the corporation does not part with any of its assets, none of its property is distributed to the shareholders, but merely a certificate showing that he holds a larger number of shares of stock of the company but the same proportionate share he held before. To illustrate; if a corporation has been prosperous and in addition to earning and paying its regular cash dividend has accumulated a surplus equal to its original capital and declares a stock dividend of 100% each stockholder owning 50 shares would receive an additional 50 shares, but not only would his proportionate interest in the corporation be the same as before, but the inherent value of his 100 shares would be about the same of the inherent value of the 50 shares originally held by him was before the increase. On the other hand a dividend payable in cash or in property of

the corporation would take from the corporation some of its assets and turn them over to the shareholders. With the declaration of the dividend and its payment the title would vest in the shareholder, would be treated as income and go to the life tenant.

While as appears from the cases above cited the Massachusetts rule has been followed in a number of jurisdictions, probably by far the larger number of Courts have rejected the rule notwithstanding the fact that it has been approved by the Supreme court of the United States.

The Massachusetts rule is largely one of practical convenience, and does not always work out equitably, even though it may be based upon sound reasoning, as to which there is some question. And so we find other states following the *Pennsylvania Rule*, which has been expressed in the following language:

“The rule that whether an extraordinary cash dividend, or a stock dividend, declared during the term of a life estate in stock in a corporation is to be considered as income belonging to the life tenant, or as capital belonging to the remainderman, is to be determined by the time, with relation to the commencement of the life term, when the fund out of which the dividend is made accumulated.”¹⁰

Under this rule the action of the corporation in deciding the form of the dividend, whether cash or stock is not regarded as a determining fact, as in Massachusetts, but the important consideration is “when was the dividend earned.” If prior to the vesting of the life estate it must be regarded as

10. 14 Corpus Juris 832.

capital and go to the remainderman; if after the vesting of the life estate it would be income and go to the life tenant; and if partly before the vesting of the life interest and partly during the life estate it should be apportioned. This rule is based upon considerations of equity and has been adopted in the cases cited in the footnote.¹¹ *Soehnlein vs. Soehnlein*, a very fully considered case, by a divided court refused to follow the Massachusetts cases and the decision of the Supreme Court of the United States in *Gibbons vs. McMahon*, and indeed in the majority opinion rather severely criticized the opinion in that case, saying that it was not only opposed to the great weight of judicial authority, but that it was not based on sound logic, and moreover produced results which were inequitable. The Wisconsin court pointed out that the disposition of dividends depended upon the purpose and intention of the donor of the stock, and that it was illogical to hold that the action of the corporation could be permitted to nullify that intention. And the Supreme court of Vermont has also criticized the case of *Gibbons vs. McMahon* in *In re Heaton's Estate*.¹²

However, the Supreme court of the United States has adhered to the doctrine of the *Gibbons* case in the much later case of *Eisner vs. MacComber*,¹³ a case in which the question was presented in a different form however, namely whether

11. *In re Osborn*, 209 N. Y. 450. *Holbrook vs. Holbrook*, 74 N. H. 201. *Balletine vs. Young*, 79 N. J. Eq. 70. *Wallace vs. Williams*, 9 S. C. 61. *In re Eaton*, 89 Vt. 550. *Duffill's Estate*, 180 Cal. 748. *Pritchett vs. Trust Co.*, 96 Tenn. 472. *Earp's Appeal*, 28 Pa. 368. *Thomas vs. Gregg*, 78 Md. 545. *Wilberding vs. Miller*, 88 Ohio St. 609. *Soehnlein vs. Soehnlein*, 146 Wis. 330.

12. *In re Heaton's Estate*, 89 Vt. 550.

13. *Eisner v. MacCombe*, 252 U. S. 189.

an income tax must be paid on a stock dividend. In this case there was a dissenting opinion, and it can be readily understood that a feeling might exist that for purposes of taxation a stock dividend should be considered income. However, the majority of the Supreme court held that it was capital and not income.

The question of the proper distribution of these extraordinary dividends whether cash or stock as between life tenant and remainderman, is an important and difficult one, and strong reasons can be urged in support of the two doctrines described as the Massachusetts and Pennsylvania doctrines respectively. If I were to venture an opinion it would be that the trend of decisions is toward the Pennsylvania rule. The question has not as yet been adjudicated by any of the Appellate courts of Missouri, but a case has recently been decided in one of the circuit courts of the state, which in view of the conflict of authority followed the decision of the Supreme court of the United States in *Gibbons vs. McMahon*, supra, but the case is still pending on a motion for a new trial, and in any event the question must be regarded as open until passed upon by our Supreme court.

It may be added that while the early English rule gave all extraordinary or unusual dividends, whether cash or stock to the remainderman, treating them as capital and not income, the more recent rulings in that country seem to be in accord with the Massachusetts doctrine.¹⁴

14. *Paris v. Paris*, 10 Ves. Jr.; 85 (1804) Old rule. *Jones v. Evans*, 1 Ch. 23 (1913).