

Apportionment of Extraordinary Dividends Between Life Tenant and Remainderman

All courts are agreed that the basic principle governing the distribution of trust receipts between a life beneficiary and a remainderman is that the intention of the settlor shall be given effect unless it is contrary to law.¹ In the usual case, where the settlor has directed that the income or earnings be paid to a beneficiary for life, with a remainder over, this means that ordinary cash dividends, declared on stock held by the trust are awarded to income, that is, to the life beneficiary, if they are declared out of corporate earnings and while the stock is subject to the life interest. If, however, such a dividend is declared before or after the existence of the life interest it is allocated to corpus, that is, to the remainderman; as is a dividend declared out of capital, regardless of the time of its declaration.² While there have been few cases on the subject, it is generally believed that the same rules apply to ordinary stock dividends, although some jurisdictions refuse to differentiate between ordinary and extraordinary stock dividends, but treat all stock dividends as extraordinary, or at least award all such dividends to corpus.³ Under these rules governing the distribution of ordinary dividends the time relative to the commencement of the life interest during which the surplus out of which the dividend was earned is immaterial. If the dividend was declared during the life interest it is awarded to income in its entirety; if it was declared prior to the commencement of, or after the termination of the life interest, it goes, in its entirety, to corpus.⁴ The sole exception to this rule against apportionment is New Jersey, which in this respect treats ordinary dividends the same as extraordinary dividends.⁵

¹ *In re Anson's Settlement*, [1907] 2 Ch. 424; *Gibbons v. Mahon*, 136 U.S. 594 (1890); *Hublely v. Wolfe*, 329 Ky. 574, 82 S.W. 2d 830 (1935); *Gray v. Hemenway*, 268 Mass. 515, 168 N.E. 102 (1929); *In re Osborne*, 209 N. Y. 450, 103 N.E. 723 (1913); *In re Crozers Estate*, 336 Pa. 266, 9 A. 2d 535 (1939). Effect was not given the settlor's intention in *In re Megrue*, 224 N.Y. 284, 120 N.E. 651 (1918); *In re Maris Estate*, 301 Pa. 20, 151 Atl. 577 (1930); where to do so would have violated a statute against accumulations.

² *In re Marjoribanks*, [1923] 2 Ch. 307; *Harding v. Staples*, 111 Conn. 325, 149 Atl. 846 (1930); *Robinson v. Robinson's Ex'r.*, 221 Ky. 245, 298 S.W. 701 (1927); *Anderson v. Bean*, 272 Mass. 432, 172 N.E. 647 (1930); *In re Osborne*, *supra* note 1; *Earp's Appeal*, 28 Pa. 368 (1857).

³ RESTATEMENT, TRUSTS, § 236, comment *h*; Cf. *In re Billard*, 147 Misc. 472 (Sur. Ct. 1933). For the view that all stock dividends are extraordinary, see *Rhode Island Hospital Trust Co. v. Tucker*, 52 R.I. 277, 160 Atl. 465 (1932).

⁴ *In re Osborne*, *supra* note 1; *Earp's Appeal*, *supra* note 2.

⁵ *Lang v. Lang*, 57 N.J. Eq. 325, 41 Atl. 705 (1899); *Hagedorn v. Arens*, 106 N.J. Eq. 377, 150 Atl. 4 (1930).

In comparison with this relatively well settled state of the law regarding ordinary dividends, there is an irreconcilable conflict among the cases in regard to extraordinary dividends. The controlling factor is still, theoretically at least, the intention of the settlor, but in most cases the settlor has not manifested any intention other than to say that "income," "earnings" or "dividends" and the like are to go to the life beneficiary. Since the problem is determining whether an extraordinary dividend is income, such general manifestations of interest on the settlor's part can afford no guide to the court in distributing the extraordinary dividend.⁶ As a matter of fact the problem probably never even occurred to the settlor. A few cases have held that the court should look into the surrounding circumstances of each case and from them infer some intention on the part of the settlor, but by far the majority of the cases have been decided by resort to some definite rule of law. For example, in *Wilberding v. Miller*⁷ the Ohio Supreme Court said, ". . . there should be no arbitrary, rigid rule which would prevent the court from looking into the facts and circumstances of each case to determine the rights of the parties according to justice and equity." This case was, however, overruled by *Lamb v. Lahmann*,⁸ in which the court said,

There is something attractive and appealing about a proposition to avoid an arbitrary rigid rule and decide controversies according to justice and equity, but it is more important and satisfying to establish general rules whereby all causes can be decided with measurable uniformity.

As a result in the application of these general rules the facts of any particular case are unimportant except as they might cause the court to modify or change the rule it had previously adopted, or to indulge in a more diligent search for some manifestation of the settlor's intention in order to avoid what appears to be a harsh result.⁹

In England there were developed two rules for the distribution of extraordinary dividends, the so-called early and later English rules. Under the early English rule all extraordinary dividends were given to corpus.¹⁰ There were many departures from this rule, however, and in *Bouch v. Sproule*¹¹ it was limited to corporations which do not have the power to increase their capital, and the later English rule was established. Under this rule the dividend is income if the corporation intended a distribution of earnings, and cor-

⁶ *In re Heaton*, 89 Vt. 550, 96 Atl. 21 (1916).

⁷ 88 Ohio St. 609, 100 N.E. 665 (1913).

⁸ 110 Ohio St. 59, 143 N.E. 276 (1924).

⁹ *In re Osborne*, *supra* note 1.

¹⁰ *Brander v. Brander*, 4 Ves. 800, 31 Eng. Reprint 414 (1799); *Irving v. Houston*, 4 Paton (Scot.) 521 (1803).

¹¹ 12 App. Cas. 385 (1887).

pus if the corporation intended to capitalize the earnings. Thus, the intention of the corporation is the controlling factor, although the courts will look through the form of the corporate act to ascertain its true substance. The rule was stated as follows:

When a testator or settlor directs or permits the subject of his disposition to remain as shares or stocks in a company which has the power either of distributing its profits as a dividend, or converting them into capital, and the company validly exercised this power, such exercise of its power is binding on all persons interested under the testator or settlor in the shares; and consequently what is paid by the company as dividend goes to the tenant for life, and what is paid by the company to the shareholder as capital, or appropriated as an increase in the capital stock of the concern, inures to the benefit of all who are interested in the capital.¹²

There is, under this rule, as under the general rules relating to ordinary dividends, no apportionment of the dividend.

In the United States there have developed three principal rules; the Massachusetts rule, the Pennsylvania rule, sometimes called the American rule, and the Kentucky rule, formerly known as the New York and Kentucky rule. Of these three rules only the Massachusetts and Pennsylvania rules have received widespread support. The Massachusetts rule closely resembles the English rule in that it gives all cash dividends to income and all stock dividends to corpus, without differentiating between ordinary and extraordinary dividends.¹² Under this rule the character of the dividend is the controlling factor, as under the English rule, and there is no apportionment of the dividend. While the expressed purpose of the corporation is persuasive, the courts applying this rule will look behind such expressions to ascertain the real purpose or intention of the corporation, as is done by the English courts.¹⁴ The critical determinations which must be made by a court or trustee in order to apply the rule are, first, that the dividend represents earnings, not capital; second, that it was declared during the life interest; and third, its substantial character as a stock or cash dividend. In *Minot v. Paine*,¹⁵ the leading Massachusetts case applying the rule, the Massachusetts Supreme Court said, "A simple rule is to regard dividends, however large, as income, and stock dividends, however made, as capital."

The Pennsylvania rule stands out in sharp contrast to the Massachusetts and English rules. Under this rule an extraordinary divi-

¹² *Bouch v. Sproule*, *supra* note 11.

¹³ *Gibbons v. Mahon*, *supra* note 1; *Minot v. Paine*, 99 Mass. 108 (1868).

¹⁴ *Harding v. Staples*, *supra* note 2; *Talbot v. Milliken*, 221 Mass. 367, 108 N.E. 1060 (1915).

¹⁵ *Supra* note 13.

dend of either stock or cash is awarded to income or corpus, or apportioned between them, depending on the time, relative to the existence of the life interest, during which the surplus out of which the dividend was declared was earned and the effect which the declaration of the dividend has on the value of the corpus. The source of the dividend is the controlling factor. If the dividend was declared out of surplus accumulated prior to the commencement of the life interest it is awarded entirely to corpus, while if it was declared out of surplus earned after the commencement of the life interest it is given to income. If, however, the surplus out of which it was declared was earned both before and during the existence of the life interest the dividend is apportioned between income and corpus.¹⁶ The method of apportionment followed in most states which have adopted the rule is to allocate so much of the dividend to corpus as is required to make the intrinsic value of the corpus after the declaration of the dividend equal to its value as of the date of the commencement of the life interest, with adjustments for capital gains or losses.¹⁷

The effect of the rule is to give to the life tenant the income which has been earned since the trust came into being, but, at the same time, to preserve the value of the corpus as it was at the date of the death of the testator, or, to use a more convenient term, to preserve the intact value of the estate. . . . An extraordinary dividend paid out of accumulated earnings presumptively belongs to the life tenant, but if it be shown that the distribution impairs the intact value of the estate the court will make an apportionment.¹⁸

The courts of New Jersey, however, in their application of the Pennsylvania rule use a different basis of apportionment. Under their approach the dividend is apportioned so that the ratio of that part of the dividend allocated to corpus to that part allocated to income equals the ratio of that part of the surplus earned prior to the commencement of the life interest to that part earned after such time.¹⁹ In order to apply the Pennsylvania rule the court or trustee must determine, first, that the dividend was declared out of earnings; and, second, the time, in relation to the life interest, when the surplus out of which the dividend was declared was earned, and the effect of the dividend on the value of the corpus, or, in New Jersey, the exact ratio between the surplus earned prior to, and after, the commencement of the life interest.

¹⁶ *Thomas v. Gregg*, 78 Md. 545, 28 Atl. 565 (1894); *Earp's Appeal*, *supra* note 2; *In re Boyle*, 235 Wis. 282, 293 N.W. 150 (1840).

¹⁷ See cases *supra* note 16; *In re Barnes Estate*, 338 Pa. 555, 12 A. 2d 912 (1940).

¹⁸ *In re Nirdlinger's Estate*, 290 Pa. 457, 139 Atl. 200 (1927).

¹⁹ *Lang v. Lang*, *supra* note 5; *Ballantine v. Young*, 79 N.J. Eq. 70, 81 Atl. 119 (1911).

What is sometimes called the Rhode Island rule is in reality a combination of the Massachusetts and Pennsylvania rules. The Rhode Island Supreme Court said, in *Rhode Island Hospital Trust Co. v. Tucker*:²⁰

The Massachusetts rule, so far as so-called stock dividends are concerned, appears to be logical, to be founded on correct legal principles, and to be a rule by which justice may be done between the life tenant and the remainderman. However, it may be pertinent to say that we cannot follow the Massachusetts rule in its application to extraordinary cash dividends the payment of which impairs the surplus accumulated before the creation of the trust.

The third major rule developed in this country is the Kentucky rule. This rule states that all extraordinary dividends declared out of earnings are income.²¹ The only requirement is that they be declared during the existence of the life interest. Thus, the character and the source of the dividend are immaterial, the time of its declaration is the only criterion. In *Hite v. Hite*²² the court said:

Where a dividend, although declared in stock, is based upon the earnings of the company, it is in reality, whether called by one name or another, the income of the capital invested in it. . . a singular state of case — it seems to us, an unreasonable one — is presented if the company, although it rests with it whether it will declare a dividend, can bind the courts as to the proper ownership of it, and by the mode of payment substitute its will for that of the testator, and favor the life tenants over the remaindermen, as it may desire.

In spite of the differences in principle among the Massachusetts, Pennsylvania and Kentucky rules, their application does not always produce different results. An extraordinary cash dividend declared during the life interest out of earnings accumulated during that interest would be given to income by all three rules. Such a dividend representing earnings accumulated before the commencement of the life interest would be awarded to income by both the Massachusetts and Kentucky rules and to corpus by the Pennsylvania rule. If the surplus were earned partly before and partly after the commencement of the life interest, the dividend would, as above, be given to income by the Massachusetts and Kentucky rules, but would be apportioned under the Pennsylvania rule. In the case of an extraordinary stock dividend which is both declared and earned during the life interest, the dividend would be allocated to income by the Pennsylvania and Kentucky rules, but would be

²⁰ *Supra* note 3.

²¹ *Hite v. Hite*, 93 Ky. 257, 20 S.W. 778 (1892); *Hublely v. Wolfe*, *supra* note 1.

²² *Supra* note 21.

considered corpus under the Massachusetts rule. Such a dividend earned before the commencement of the life interest would be allocated to corpus by the Massachusetts and Pennsylvania rule, but would be income under the Kentucky rule. If the surplus were accumulated both before and during the commencement of the life interest it would be considered income under the Kentucky rule, corpus under the Massachusetts rule, and would be apportioned under the Pennsylvania rule.

It is difficult to compare these three rules. As Scott points out “. . . the reasons in favor of one are not such as can be easily balanced against each other.”²³ In general, the arguments have been of two types, those based on practicality and those based on legal principle. The proponents of the Massachusetts rule are quick to compare its relative simplicity with the complications which may attend the application of the Pennsylvania rule. In discussing the Massachusetts rule the Supreme Court of Illinois said:

The doctrine is based upon the impracticability of determining the comparative rights of different persons in a particular share of stock, of going behind the votes of the corporation and its directors, and of investigating the corporate accounts and affairs in order to ascertain how the corporation acquired the fund out of which the dividend was declared.²⁴

The same thought was expressed in *Minot v. Paine*:²⁵

A trustee needs one plain principle to guide him; and the cestuis que trust ought not to be subjected to the expense of going behind the action of the directors, and investigating the concerns of the corporation. . . .”

In this respect those courts which are committed to the Pennsylvania rule have characterized the other rules, especially the Massachusetts rule as being one of expediency.

[The other rules] are clearly arbitrary, and adopted for the convenience of the trustees in the discharge of their duties and the courts who instruct them in their duties.²⁶

Without doubt the Massachusetts rule is the easier of the two to apply, although both rules require the fact that the dividend was declared out of earnings be established, and under the Massachusetts rule the affairs of the corporation may have to be inquired into in order to determine the true character of the dividend. To say, as some have, that the Pennsylvania rule is so complicated that it is impossible to apply, or that it can never produce the fair result in practice that it does in theory seems to be going a bit too far. It is difficult to apply the rule in some cases, but for the most

²³ SCOTT, TRUSTS § 857, 834.

²⁴ *Whiting v. Hagey*, 336 Ill. 86, 7 N.E. 885 (1937).

²⁵ *Supra* note 13.

²⁶ *Beattie v. Gedney*, 99 N.J. Eq. 207, 132 Atl. 652 (1926). See also *In re Nirdlinger's Estate*, *supra* note 18.

part it does seem to achieve its objectives, albeit with some difficulty and expense that would be avoided under the Massachusetts or Kentucky rules.

Concerning the logic behind the Massachusetts rule, its supporters take the position that a stock dividend is not a true dividend, and that therefore the life beneficiary can have no claim to it.

The theory is that in the case of cash and property dividends, there is an actual severance of the subject of the dividend from the corporate assets, whereas stock dividends involve only readjustments of the corporate structure, the corporate assets remaining the property of the corporation as fully as they were before.²⁷

Further, the distribution of stock dividends to the life beneficiary reduces the voting power of the corpus, although control over corporate affairs is probably not a factor in many cases. In this regard, the supporters of the Pennsylvania rule point out that many other factors, beyond the control of the trustee or the courts, may also reduce the proportionate interest held by the trustee. They also claim that as a general rule the settlor is more likely to favor the life beneficiary than the remainderman. This, however, seems too problematical to be a valid legal argument. The basic objection to allocating stock dividends entirely to corpus is that such a rule may, if the corporation declares most of its dividends in this form, deprive the life beneficiary of any substantial income from the trust. It is contended that such a result is both unfair and contrary to the intention of the settlor. It must be admitted that the Massachusetts rule does, in some cases, seem to produce a harsh result. With regard to any argument based on the settlor's intention it must be remembered that these rules apply only in cases where the settlor has not manifested any particular intention. The most that can be said is that the court assumes that it would have been contrary to the settlor's intention; at best this is a not too reliable argument. It has also been claimed that the Massachusetts rule places the intention of the corporation over that of the settlor. This also is a faulty argument. Where the rule is to be applied there is no intention of the settlor to be displaced because he has manifested no intention.

In most discussions of these rules it is said that, aside from the foregoing argument in regard to stock dividends, there is no justification in principle for the Massachusetts rule, but that it rests solely on expediency and the complications which may occur in the application of the Pennsylvania rule.²⁸ This does not seem too sound. As the Missouri Supreme Court said:

The converse of that ruling (that all stock dividends are

²⁷ Hayes v. St. Louis Union Trust Co., 317 Mo. 1028, 298 S.W. 91 (1927).

²⁸ Scott, Trusts § 236.4; 130 A.L.R. 492, 532.

corpus) would be that money or property which is severed from corporate assets by appropriate action of the governing body of the corporation and paid as dividends, would be income. . . .²⁹

Rhode Island, however, has accepted the Massachusetts rule as regards stock dividends and rejected it in favor of the Pennsylvania rule in the case of cash dividends.³⁰ The logic of this position seems questionable. If severance from corporate assets of the subject of the dividend is the criterion, it ought to be applied to both stock and cash dividends. In England this has been done and has been stated as the basis for the later English rule. It seems to also be the basis for the Massachusetts rule, but the courts following that rule have not enunciated it as a general principle. They have reached the same practical result and they have used the argument in relation to stock dividends, but they have somehow neglected, for the most part, to recognize it as the general basis for the rule and to apply the same reasoning to cash dividends.

In view of the slight support it has received, there would seem to be little reason for discussing the Kentucky rule at length. It is criticized by the adherents of the Pennsylvania rule for allocating all dividends to income, no matter when the surplus out of which they were declared was earned, and by the followers of the Massachusetts rule for giving stock dividends to income. Even the courts of Kentucky do not seem overly fond of the rule. In *Laurent v. Randolph*³¹ the court of appeals said:

The writer of this opinion is inclined to favor the Pennsylvania rule as the fairest and most equitable rule of distribution between life tenant and remainderman. However, under the facts of the instant case the life tenant would be entitled to the distribution under any of the three rules mentioned above, and there is no reason for departing from the precedent now accepted as the settled law of this state.

The relative strength of the various rules, in terms of the number of jurisdictions supporting them has always been in a state of flux as states previously committed to one rule change to another or new jurisdictions adopt a rule for the first time. New York is an excellent example of how a state may change rules. Originally it followed the Kentucky rule.³² In the famous case of *In re Osborne*³³ the Pennsylvania rule was adopted, partly from considerations of principle and partly in order to avoid what the court considered a harsh result, which would have obtained under the Kentucky rule. Then, in 1926, the Legislature enacted the substance of

²⁹ *Hayes v. St. Louis Union Trust Co.*, *supra* note 27.

³⁰ *Rhode Island Hospital Trust Co. v. Tucker*, *supra* note 3.

³¹ 306 Ky. 134, 206 S.W. 2d 480 (1947).

³² *In re Kernochan*, 104 N.Y. 618, 11 N.E. 149 (1887); *McTouth v. Hunt*, 154 N.Y. 179, 48 N.E. 548 (1897).

³³ *Supra* note 1.

the Massachusetts rule into law in regard to stock dividends.³⁴ There is also no clear cut unanimity of opinion among the text writers on the subject. Mr. Scott states that the Pennsylvania rule is more just, and generally seems to prefer it, although he admits that the Massachusetts rule is preferable on the ground of simplicity.³⁵ Mr. Bogert, on the other hand, takes the position that, while the objects of the Pennsylvania rule are "praiseworthy," its attendant complications "are such that there can be no assurance of even substantial realization of this ideal," and therefore prefers the Massachusetts rule in the final analysis.³⁶

Beginning in the 1920's, however, there has been a definite trend favoring the Massachusetts rule, both judicially and on the part of various state legislatures. Prior to that time approximately thirteen jurisdictions supported or favored the Pennsylvania rule,³⁷ two states apparently supported the Kentucky rule,³⁸ one adopted both the Pennsylvania and Kentucky rules in part,³⁹ and one had rejected the Massachusetts rule without distinguishing between the Pennsylvania and Kentucky rules.⁴⁰ Eight jurisdictions followed the Massachusetts rule.⁴¹ At the present time, by contrast, twenty-six jurisdictions have adopted, or favor, the Massachusetts rule,⁴² eight the Pennsylvania rule,⁴³ and two have adopted both rules in part,⁴⁴ the rest of the distribution remaining unchanged. The only significant event running contrary to this general trend in favor of the Massachusetts rule was the adoption, in 1935, of the Pennsylvania rule by the Restatement of Trusts.⁴⁵

The legislative trend toward the Massachusetts rule has been due, for the most part, to the adoption of that rule by the Uniform Principal and Income Act, which has now been adopted in fourteen

³⁴ N. Y. PERS. PROP. LAW § 17-a.

³⁵ SCOTT, TRUSTS § 236.3

³⁶ BOGERT, TRUSTS AND TRUSTEES § 857.

³⁷ California, Iowa, Maryland, Minnesota, Mississippi, New Hampshire, New Jersey, New York, Pennsylvania, South Carolina, Tennessee, Wisconsin and Hawaii.

³⁸ Delaware and Kentucky.

³⁹ Rhode Island.

⁴⁰ Vermont.

⁴¹ Connecticut, Georgia, Illinois, Maine, Massachusetts, North Carolina, West Virginia and the United States courts.

⁴² Alabama, California, Connecticut, Florida, Georgia, Illinois, Indiana, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Nebraska, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Virginia, West Virginia, and the United States courts.

⁴³ Iowa, Minnesota, Mississippi, New Hampshire, New Jersey, Tennessee and Wisconsin.

⁴⁴ New York and Rhode Island.

⁴⁵ RESTATEMENT, TRUSTS § 236 (b).

states.⁴⁶ The reason for this choice of rules is stated in the Commissioners Prefatory Note:

The aim followed in this act is that of as simple and convenient administration of the estate as is consistent with fairness to all beneficiaries. It is felt, too, that workable rules are after all nearest the settlor's probable intent, for he has not probably contemplated extensive and detailed book-keeping adjustments of the property he has destined for his donees. When the first draft of the act was presented, the Conference voted to follow the so-called Massachusetts rule . . . Experience has shown that, however praiseworthy the intent, the later rule (Pennsylvania) is unworkable, since neither trustee nor court has the means to value the corporate assets in such a way as to secure the fair adjustment aimed at.

Of the states that have adopted this Act, three had previously adhered to the Pennsylvania rule, namely California, Maryland, and Pennsylvania itself. The Supreme Court of Pennsylvania, although it refused to apply the act retroactively, conceded that its adoption "may have been a wise and even desirable legislative enactment."⁴⁷ The only other statutory change was the adoption of the Massachusetts rule in New York as regards stock dividends. Commenting on this change, Cardozo, J., said:

The rule previously applied had resulted in so many complications and obscurities as to be almost unworkable in practice. . . . The Legislature evinced its will that there should be an end to these complexities in the administration of the law of trusts.⁴⁸

There has been no case of a state, which had previously adopted another rule, changing the rule by judicial decision. South Carolina, which had previously indicated a preference for the Pennsylvania rule, now seems to favor the Massachusetts rule; indications by way of dicta are all the supreme court of that state has given, however.⁴⁹ Several states have adopted a rule for the first time, however, and all have supported the Massachusetts rule. These are, in the order in which they adopted the rule, Ohio, Missouri, Michigan, Nebraska, Indiana, Alabama and South Dakota. The reason most often given was that "a stock dividend is not in any true sense a dividend at all."⁵⁰ Most of the opinions also were, in the

⁴⁶ Alabama, California, Connecticut, Florida, Illinois, Louisiana, Maryland, North Carolina, Oklahoma, Oregon, Pennsylvania, Texas, Utah and Virginia.

⁴⁷ *In re Crawford's Estate*, 362 Pa. 458, 67 A. 2d 124 (1949).

⁴⁸ *People ex rel. Clark v. Gilchrist*, 243 N.Y. 473, 153 N.E. 39 (1926).

⁴⁹ *Cobb v. Fant*, 36 S.C. 1, 14 S.E. 959 (1892); *Wallace v. Wallace*, 90 S.C. 61, 72 S.E. 553 (1911); *Gist v. Craig*, 142 S.C. 407, 141 S.E. 126 (1927).

⁵⁰ *Lamb v. Lehmann*, 110 Ohio St., 143 N.E. 276 (1924); *Hayes v. St. Louis Union Trust Co.* 317 Mo. 1028, 298 S.W. 91 (1927); *In re Estate of Joy*, 247 Mich. 418, 225 N.W. 878 (1929); *United States Trust Co. v. Cowin*, 121 Neb. 427, 237 N.W. 284 (1931); *Powell v. Madison Safe Deposit and Trust Co.*, 208 Ind. 432,

language of the Michigan Supreme Court, "somewhat influenced by the practical difficulties . . . which have been met with in applying a rule which provides for apportionment."⁵¹ One case pointed out that "the inherent fallacy of the Pennsylvania rule is that it regards the corpus of the trust as of its value at the time the trust was created, while the fact is . . . the stock, itself, is the corpus, and it may rise or fall in value."⁵²

It was also said in several of the opinions that the actions of the corporation, in the absence of any contrary intention on the part of the settlor, must be considered as binding.

Even in the light of these recent cases it is difficult to evaluate the Massachusetts and Pennsylvania rules on a logical basis. They seem, in fact, to be the result of two fundamentally different approaches to the problem. The Pennsylvania rule treats the corpus of the estate as having a certain intrinsic value as of the time it became subject to the life interest. This value is then protected and any increments to the stock which do not deplete this value and are declared out of corporate earnings are considered income to the trust, either because it is assumed that this is the fair way to distribute such increments, or because it is assumed that such was the probable intention of the settlor. On the other hand, the Massachusetts and English rules proceed to ascertain, in the absence of the manifestation of any specific declaration by the settlor, what is income and what is corpus. The criterion used is the action of the corporation; the question is, did the corporation distribute this dividend as income or as an increment to the corpus of the trust? Rather than try to figure out what is fair, or what the settlor might have intended, this view starts with the settlor's direction that the "income" to the trust be given the life beneficiary and then proceeds to define income in terms of traditional legal concepts. If this approach needs any justification other than that it is the only way to handle the problem without injecting extrinsic matters into the situation, it can be assumed that the settlor knew the beneficiaries would be, and intended that they should be bound by the acts of the corporation since that is one of the inherent qualities of stock ownership.

Both rules are logical. The Massachusetts rule seems more in keeping with traditional legal thought, it is more analytically correct perhaps, but it is also perhaps not quite as fair in the distribution it will require. If these were the only factors to be considered,

196 N.E. 324 (1935); *First National Bank of Tuscaloosa v. Hill*, 241 Ala. 606, 4 So. 2d 170 (1940); *Kirby v. Western Surety Co.*, 70 S.D. 483, 5 N.W. 2d 405 (1942).

⁵¹ *In re Estate of Joy*, *supra* note 50.

⁵² *United States Trust Co. v. Cowin*, *supra* note 50.

the Pennsylvania rule would appear to be preferable. There is, however, also the practical matter of applicability. While the difficulties to be encountered by the courts in the application of the rule may not be sufficient to justify preferring the Massachusetts rule in its place, the fact that it forces trustees to decide between expending considerable time and money in an attempt to investigate the affairs of a corporation or run the risk of incurring personal liability for a maldistribution of trust receipts would seem to weight the scales in favor of the Massachusetts rule. This indeed has been the trend in recent times.

The fact that any rule adopted will yield before a manifestation of the settlor's intention in respect to the matter would seem to provide both another reason for preferring the Massachusetts rule and what is perhaps the only really satisfactory solution to the problem. So long as this is the case any unfairness which may be found in any rule can be avoided if the settlor will specify exactly what he wants done with extraordinary dividends. The Massachusetts rule "forces settlors who desire to adjust matters in a different way to declare their intents in detail. In most large trusts operating under the rule the trustee is given discretion; or specific instructions are set forth which insure that no substantial injustice will be done to either interest under the trust."⁵³ Thus, in the final analysis, draftsmanship can provide the only real answer to such a question as this. Regardless of the logic behind rules, there is, and probably will continue to be, a split of authority. The only way for a settlor to be certain extraordinary dividends will be distributed according to his wishes is to give the matter some thought and then make definite provisions in the will or trust instrument concerning the matter.

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⁵³ BOGERT, TRUSTS AND TRUSTEES § 857.