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Underproductive Trust Property in Florida: Sacrificing Yearly Return for Administrative Convenience

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NOTES

UNDERPRODUCTIVE TRUST PROPERTY IN FLORIDA: SACRIFICING YEARLY RETURN FOR ADMINISTRATIVE CONVENIENCE*

INTRODUCTION

The trustee directed to pay income to one trust beneficiary for a period of time and subsequently to remit the principal to another is expected to act prudently to maximize both the life tenant's and the remainderman's interests.[1] His duty is to strike a fair balance between the need to maintain an adequate current flow of cash to the income beneficiary, while accumulating and protecting the trust principal for its future recipient.[2] Even the most conscientious trustee can find himself in a quandary, however, when he must deal with certain trust properties which may be unquestionably solid investments in terms of either high yield or a safe eventual recoupment, but do not satisfy the expectations of both successive beneficiaries. This difficulty is compounded when a testamentary trust is being administered because the settlor is unavailable as an arbiter in the matter.

Accordingly, underproductive[3] trust assets can constitute a major problem for the fiduciary. Although such properties as long-term growth stocks,[4] valuable paintings, and unimproved land may well satisfy the desires of the remainderman, the life tenant could receive little or no currently-flowing income. To avoid liability to the life tenant for resultant losses, the trustee might attempt to look to the trust instrument for guidance, but its language is often subject to different interpretations or is silent on this issue.[5] Because Florida law no longer generally requires a trustee to petition the court to determine the propriety of his actions,[6] the trustee would best be served by a fixed, basic

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1. *See generally* A. SCOTT, THE LAW OF TRUSTS § 232 (3d ed. 1967).

2. *Id.* § 240.

3. "Underproductive" as used in this note describes property which does not produce an adequate return for the income beneficiary, and is interchangeable with the word "unproductive." Older Florida law in this area, FLA. STAT. § 690.12 (1937), followed the lead of the original UNIFORM PRINCIPAL AND INCOME ACT (1931) (U.P.I.A.) in using the term "unproductive estate." The revised U.P.I.A. (1962) refers to "underproductive property." Florida has followed this lead. FLA. STAT. § 738.12 (1979).

4. *See* Estate of Bissinger, 212 Cal. App. 2d 831, 834, 28 Cal. Rptr. 217 (1963) for a discussion of how a trustee should deal with a trust consisting primarily of long-term low current yield "glamour issue" stocks. *See generally* G. BOGERT, TRUSTS AND TRUSTEES §§ 841-859 (2d ed. 1962). See also text accompanying notes 208-223 *infra.*

5. For suggestions on provisions the trust settlor should include to avoid problems with underproductive property, *see* Clark, *Power to Invest Without Yield,* 100 TR. & EST. 495, 496 (1961).

6. *See generally* FLA. STAT. § 737.402 (1979) on trust administration, which gives trustees

rule which would allow him to adjust the competing interests equitably without having to take the extraordinary measure of asking a court's advice.[7]

The most common approach to underproductive trust property is that taken by the Restatement of Trusts[8] and the Uniform Principal and Income Act,[9] which mandate a future sale of the income-deficient asset, apportioning the proceeds between the successive beneficiaries.[10] The 1975 revision of Florida probate and trust law included an innovative modification of this general rule. By requiring each trust asset to produce a specified level of annual income in lieu of apportionment,[11] the 1975 statute granted a considerably higher percentage of required income than most other state laws.[12]

However, by enacting the 1977 amendment to the underproductive trust property law,[13] the Florida legislature apparently attempted to accommodate the wishes of the trustee at the expense of the income beneficiary. Although the annual income payment requirement has been retained, the current statute merely states that a minimum rate of return by the entire trust estate must be achieved.[14] This new law in effect authorizes the trustee to retain underproductive assets, which in most circumstances would violate the generally accepted prudent man rule for trust investments.[15] The fiduciary's traditional duty to

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tremendous powers to make any prudent transactions within the guidelines of proper practice and the trust instrument. *Cf.* FLA. STAT. § 733.612 (1979) for the equivalent powers of a personal representative.

7. *See* Younger, *Apportioning Receipts From Wasting and Unproductive Assets: A Comment on the New Principal and Income Act*, 40 N.Y.U. L. REV. 1118, 1121 (1965). The drafters of the U.P.I.A. stated that they intended to provide for "as simple and convenient administration of the estate as is consistent with fairness to all beneficiaries." U.P.I.A. (1931) (Commissioners Prefatory Note).

8. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 240-241 (1959).

9. *See* U.P.I.A. § 12 (1962).

10. Apportionment was the common law remedy and is still used by most states, the Restatement, and the U.P.I.A. See generally notes 18-24 and accompanying text, *infra*.

11. FLA. STAT. § 738.12(1) (1975) stated that if a trust asset did not produce at least two percent of its inventory value in any year, the fiduciary was directed to pay the income beneficiary four percent of the inventory value plus any carrying charges upon the asset paid out of income during that year.

12. Although the 1931 and 1962 versions of the U.P.I.A. granted respectively five and four percent of the net sale proceeds of the underproductive asset along with incidental expenses, the life cestui actually rceived much more under the 1975 statute. The 1931 provision, which is still the law in fifteen states, failed to reimburse the life cestui for one year of the property's income-deficiency. U.P.I.A. § 11(3) (1931). Although the 1962 U.P.I.A. has eliminated this problem, the life tenant is still forced to wait until the asset is disposed of, which delays reinvestment of the property longer than would probably have been the situation under the 1975 Florida law. In contrast, the RESTATEMENT (SECOND) OF TRUSTS § 241 (1959) uses a nebulous "current rate of return on trust investments" standard which would be difficult to apply in practice. See text accompanying notes 96-106, *infra*.

13. *See* FLA. STAT. § 738.12(1)-.12(2) (1979). Compare this provision with FLA. STAT. § 738.12(1) (1975).

14. *Id.*

15. *See* FLA. STAT. §§ 518.11, 737.302 (1979). See also notes 192-193 and accompanying text, *infra*.

purge the trust property of low or no income-generating assets[16] has therefore inexplicably been removed with only limited solace to the life tenant.

This note will explore the various doctrinal attempts to solve the problem of underproductive trust property, and examine the present course that Florida has chosen in this field. Particular emphasis will be placed on the common law methods incorporated into the Uniform Principal and Income Act,[17] which thirty-six states have now partially or completely adopted.[18] In addition, the methods which a Florida fiduciary and trust instrument draftsman could employ to deal with this difficulty are analyzed. As a suggested substitute to the current Florida underproductive trust property provision, an alternative statute will be proposed insuring better protection of the interests of all concerned parties.

THE TRADITIONAL APPROACH: THE DUTIES OF SALE AND APPORTIONMENT

At common law,[19] courts responded to the income beneficiary's plight by forcing sale of underproductive asset and apportionment of the net proceeds.[20] When granted, this remedy gave the life cestui a portion of the receipts upon the future sale of the property,[21] reimbursing him for the loss of income during

16. *See* RESTATEMENT (SECOND) OF TRUSTS § 241, Comment b (1959).

17. *See* Younger, *supra* note 7, at 1122-26.

18. *See* lists of states at 7A UNIFORM LAWS ANNOTATED 15-16 (Supp. 1979). Twenty-one states have embraced the 1962 version, while fifteen states still use the 1931 provisions.

19. *See, e.g.*, Wallace v. Julier, 3 So. 2d 711, 718 (Fla. 1941); *see generally* A. SCOTT, *supra* note 1, §§ 240-241, which describe the past history of apportionment. Florida initially followed much of the common law approach.

20. *See* A. SCOTT, *supra* note 1. §§ 240-241. Florida adopted the apportionment method through its enactment of the U.P.I.A. in 1937, but dropped it in the 1975 revision of the principal and income provisions. The 1977 amendments failed to reinstate this procedure. *Compare* FLA. STAT. § 690.12 (1937) *with* FLA. STAT. § 738.12 (1975) *and* FLA. STAT. § 738.12 (1979).

21. The most commonly-applied equation for determining the income beneficiary's share of the net proceeds of sale is that found in the Restatement, which uses a formula similar to the one involved in discounting a note or other future cash sum obligation. If "X" equals the amount of permanent principal to be retained after sale, "A" equals the number of years for which the life cestui was entitled to income, "B" equals "the current yearly rate of return on trust investments" and "C" equals the net proceeds of the sale, the proper equation will be $X + ABX = C$. Therefore, $X = C/(1 + AB)$. RESTATEMENT (SECOND) OF TRUSTS § 241 (1959) (Comment i contains illustrations of the application of this formula).

Although the above method appears fairly easy to apply in practice, it suffers the major drawback of reliance on the Restatement's confusing standard of "the current rate of return" as the amount a trust asset is expected to generate. However, it does have the advantage of allowing proceeds to pass to the life cestui regardless of whether the property was sold at an amount greater or lesser than its inventory value. A. SCOTT, *supra* note 1, § 241.1.

An alternate scheme has been adopted in New York and New Jersey in certain situations for allocation of apportionment receipts. Where "P" equals the aggregate principal, "I" equals the unpaid interest, "C" equals the sale proceeds, "X" equals the life tenant's share, and "R" equals the remaindermen's share, the equations will be $I(P + I) = X/C$ and $P/(P + I) = X/C$. Bailey & Rice, *The Duties of a Trustee with Respect to Defaulted Mortgage Investments*, 84 U. PA. L. REV. 157, 173 (1936). *See, e.g., In re* Myers' Estate, 161 N.Y.S. 1111 (Surr. Ct. 1916). The primary difference between the two methods is that in the first scheme, the income bene-

the holding period of the asset.[22] Although contrary to the general rule that all gain realized from the sale of trust assets is allocated to principal,[23] apportionment was a necessary equitable exception helping both beneficiaries through sale and reinvestment.[24]

The first step toward allowing apportionment was finding of a duty to sell the underproductive property.[25] Because courts attempted to effect the settlor's intent, when this duty was specified in the trust instrument, sale and equitable conversion[26] of the asset were usually ordered.[27] Similarly, if the trust instrument indicated an intent to have a disposition and reinvestment of the proceeds of such an asset, but not to split the receipts between the current and future beneficiaries, no apportionment was allowed.[28] Finally there was no such requirement of sale if the settlor had expressly stated that the particular underproductive property should be retained.[29] However, where the asset was a tremendous burden on the trust, courts sometimes permitted deviation and directed a sale as a practical necessity, notwithstanding contrary language in the trust instrument.[30]

A confusing situation often ensued if the terms of the trust merely included a general authorization to retain trust property.[31] Such language was construed as either calling for retention of underproductive assets[32] or simply allowing

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ficiary receives income at the average trust yield, while in the latter system the rate of interest stated in the defaulted obligation controls. G. BOGERT, *supra* note 4, § 825.

22. G. BOGERT, *supra* note 4, § 825; A. SCOTT, *supra* note 1, § 241.1.

23. *See* FLA. STAT. §738.03(2)(h) (1979) exempting FLA. STAT. §738.12 (1979) from the normal requirement. *See generally* Note, *Common Stocks in Trust*, 113 U. PA. L. REV. 228 (1964).

24. *In re* Will of Haldeman, 208 Misc. 419, 143 N.Y.S.2d 396 (Surr. Ct. 1955). *See generally* Note, *Underproductive Trust Assets in New York*, 36 ST. JOHN'S L. REV. 259 (1962).

25. *See, e.g.*, Dexter v. Dexter, 274 Mass. 273, 273, 174 N.E. 493, 494 (1931).

26. Underproductive real property under the equitable conversion doctrine is treated as money which may be alternately distributed to income and corpus as long as the trust instrument includes an express or implied direction to effect this transmutation process. Archer v. Puffer, 146 Fla. 568, 1 So. 2d 565 (1941). However, there is a strong desire under Florida law for land to pass *in specie* because testators "don't just bequeath cash money in fee simple absolute." *In re* Estate of Smith, 200 So. 2d 547, 551 (Fla. 2d D.C.A. 1967).

27. *See* Walker v. Thomas, 75 F.2d 667, 669 (D.C. Cir. 1935), which indicated that a court might reject the literal meaning of the trust instrument language in order to carry out the settlor's intent of allowing apportionment. *See also In re* Bothwell's Estate, 65 Cal. App. 2d 598, 151 P.2d 298, 302 (Cal. 2d D.C.A. 1944).

28. G. BOGERT, *supra* note 4, § 829; A. SCOTT, *supra* note 1, § 241.2.

29. York v. Maryland Trust Co., 149 Md. 608, 131 A. 829 (1926). This is also the Florida approach. FLA. STAT. §§ 737.302, 401 (1979).

30. *See, e.g., In re* Pulitzer, 139 Misc. 575, 249 N.Y.S. 87 (Surr. Ct. 1931), *aff'd* 237 App. Div. 808, 260 N.Y.S. 975 (1st Dep't 1932). *But see* Comment, *Trusts—Deviation Because of Unforeseen Circumstances—Invasion of Vested Remainder for the Benefit of the Beneficiary*, 30 MINN. L. REV. 553 (1946), which noted that deviation will be only rarely permitted where the interests of another beneficiary will be invaded without his consent.

31. This problem is especially acute for testamentary trusts, which are the focal point of this note, because the determination of the settlor's intent in such a situation may be virtually impossible. For speculation on equivalent income-deficient asset matters in inter vivos trusts, *see* Shattuck, *Unproductive Trust Property in Massachusetts*, 20 B.U. L. REV. 447, 458 (1940).

32. RESTATEMENT (SECOND) OF TRUSTS § 240, Comment g (1959). *But see In re* Johnson's

otherwise imprudent investments to remain part of the portfolio.[33] As determining factors, courts examined whether the asset in question was specifically mentioned in the trust instrument,[34] particularly if the settlor had been aware of its underproductivity;[35] whether the property constituted only a small proportion of the net worth of the estate;[36] and whether the trust purposes revealed certain close relationships between the settlor and his beneficiaries.[37] If the court found at least one of the above factors, then the trust document was usually construed as imposing no duty to sell.[38] In at least one case, however, a sympathetic court directed the disposition of underproductive property despite the instrument's clear language calling for its retention.[39]

A split of authority existed where there was neither a direction to retain trust properties nor an express duty to sell.[40] The strict view looked directly to the settlor's probable intent as the controlling factor in the apportionment question.[41] Courts adhering to this concept took the position that unless the settlor expressly manifested an intent to require the trustee to dispose of the underproductive property,[42] no apportionment would be granted.[43] However,

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Will, 73 N.Y.S.2d 621 (Surr. Ct. 1947), for the concept that only a clear contrary manifestation of the settlor's intent would negate a duty to sell.

33. "Wasting property," which generally consists of depletable natural or personal resource assets such as oil wells, mines, timber land, patents and copyrights, often qualifies as a type of "overproductive property" because such property produces income but may leave nothing for the remaindermen. A. SCOTT, *supra* note 1, § 239.

34. *See, e.g., In re* Estate of Schuster, 175 Misc. 1072, 27 N.Y.S.2d 413 (Surr. Ct. 1941).

35. *Id. But cf.* Lambertville Nat'l Bank v. Bumster, 141 N.J. Eq. 396, 57 A.2d 525 (Ch. 1948) (allowing the sale of low-dividend and declining value securities despite express language in the trust instrument requiring these assets to be retained).

36. *In re* Marshall, 136 Misc. 116, 238 N.Y.S. 763 (Surr. Ct. 1930).

37. RESTATEMENT (SECOND) OF TRUSTS § 240, Comment g (1959). When the income beneficiary is a surviving spouse or other close relative of the settlor, this familial relationship has often been the strongest incentive for a court to grant apportionment. *See In re* Shepard, 186 Misc. 564, 568, 59 N.Y.S.2d 803, 809 (Surr. Ct. 1945).

38. A. SCOTT, *supra* note 1, § 240.1.

39. See note 35 *supra. See generally* Lambertville Nat'l Bank v. Bumster, 141 N.J. Eq. 396, 57 A.2d 525 (Ch. 1948).

40. A. SCOTT, *supra* note 1, § 240.1. However, most states now set a specific percentage of income as an "underproductivity level" triggering the fiduciary's duty to pay the life cestui a certain yearly amount. See note 12 *supra.* Only the Restatement and Professor Scott begrudgingly support the nebulous payment standard of "substantially less than the current rate of return on trust investments." RESTATEMENT (SECOND) OF TRUSTS § 241 (1959); A. SCOTT, *supra* note 1, § 241.

41. This was the position taken in Massachusetts, Creed v. Connelly, 272 Mass. 241, 172 N.E. 106 (1930), and New York, *In re* Satterwhite, 262 N.Y. 339, 186 N.E. 857 (1933), and later followed in Missouri, Lang v. Mississippi Valley Trust Co., 359 Mo. 688, 223 S.W.2d 404 (1949).

42. Generally, if the grantor's intent can be discerned from the trust instrument, the document controls. *See, e.g.,* FLA. STAT. § 737.402(2) (1979). *But see* Lambertville Nat'l Bank v. Bumster, 141 N.J. Eq. 396, 57 A.2d 525, 526 (Ch. 1948).

43. See note 45 *infra.* For a more lenient view towards granting apportionment, see *In re* Pulitzer, 139 Misc. 575, 579, 249 N.Y.S. 87, 93 (Surr. Ct. 1931), *aff'd,* 237 App. Div. 808, 260 N.Y.S. 975 (1st Dep't 1932).

the cases supporting this doctrine[44] may have been decided on their own facts.[45] For example, in *Creed v. Connelly*,[46] a Massachusetts court[47] denied apportionment of the proceeds of an already sold vacant lot[48] partly because the land had been only a small portion of the trust assets.[49] In *In re Marshall's Estate*,[50] the court reasoned that apportionment was not necessary because the value of the asset in question comprised less than one-twentieth of the total trust estate,[51] and the remaining trust income was more than adequate to sustain the life cestui.[52] Although presuming no intent to allow apportionment met the goals of administrative convenience and certainty for the fiduciary,[53] this concept overly favored the remainderman to the detriment of the life tenant.[54]

The jurisdictions espousing the strict view[55] have apparently softened their stances to a large extent.[56] Applying the concept that a duty to sell exists if under the circumstances[57] the settlor probably would have so intended,[58] the New York Court of Appeals in the leading case of *In re Rowland*[59] held an

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44. See note 41 *supra*.

45. For an extensive discussion of the strict view cases and their progressional interrelation, *see* Note, *Underproductive Trust Assets in New York*, 36 ST. JOHN'S L. REV. 259 (1962).

46. 272 Mass. 241, 172 N.E. 106 (1930).

47. Missouri and New York courts have also reached similar conclusions. *See* cases cited note 41 *supra*, and Furniss v. Cruikshank, 230 N.Y. 495, 130 N.E. 625 (1921), *modified per curiam*, 231 N.Y. 550, 132 N.E. 884 (1921).

48. The trustees sold the property ten years after the death of the settlor, but before the death of the life cestui, his surviving spouse. 272 Mass. at 245, 172 N.E. at 107.

49. The fiduciaries received $34,000 net proceeds from the sale of the land, but the Massachusetts Supreme Judicial Court held that the widow was only entitled to the $4,500 of income produced by the lot during the trust's ten year holding period. 272 Mass. at 248, 172 N.E. at 108. In addition, no reimbursement for carrying charges which had been paid out of income was granted. *Id. Cf.* Harvard Trust Co. v. Duke, 304 Mass. 414, 24 N.E.2d 144 (1939) (holding that where the testator was unaware of the asset's productivity, all carrying charges should be paid from principal).

50. 136 Misc. 116, 238 N.Y.S. 763 (Surr. Ct. 1930).

51. The total value of the Marshall estate was $1,082,795.19, while the real estate for which apportionment was desired sold for $45,520.83. 136 Misc. at 116, 238 N.Y.S. at 763-64. The Surrogate's Court distinguished Lawrence v. Littlefield, 215 N.Y. 561, 109 N.E. 611 (1915), where the trust fund held $8 million in unproductive real property, and Furniss v. Cruikshank, 230 N.Y. 495, 130 N.E. 625 (1921), *modified*, 231 N.Y. 550, 132 N.E. 884 (1921), which concerned a $1,400,000 total trust fund including a $490,000 parcel of land. The *Marshall* court very carefully limited its holding to the facts of the case. 136 Misc. at 118, 238 N.Y.S. at 765. For an opposing view of the proportion of the estate issue, see *In re* Johnson's Will, 73 N.Y.S.2d 621 (Surr. Ct. 1947).

52. *In re* Marshall's Estate, 136 Misc. 116, 119, 238 N.Y.S. 763, 765 (Surr. Ct. 1930).

53. This also apparently was the overriding purpose of the 1977 amendments to Florida's underproductivity statute, FLA. STAT. § 738.12 (1979). See notes 181-194 and accompanying text, *infra*.

54. *See* A. SCOTT, *supra* note 1, § 241.2.

55. *See* notes 41-54 and accompanying text, *supra*.

56. The New York courts in particular have decided to show more sympathy towards the life cestui. *See In re* Knox' Will, 163 Misc. 264, 268, 296 N.Y.S. 745, 749 (Surr. Ct. 1937).

57. See text accompanying notes 69-71 *infra*.

58. The intent of the grantor of the trust property is the key element looked to by courts in almost every trust situation. See note 41 and accompanying text, *supra*.

59. 273 N.Y. 100, 6 N.E.2d 393 (1937).

equitable conversion appropriate to rid the trust of underproductive land.[60] This remedy was held applicable to property which was either unproductive at the time of the creation of the trust[61] or which subsequently became unproductive,[62] thus following the great weight of authority.[63]

However, the *Rowland* court limited the breadth of the rule[64] by stressing that its decision was based on the particular facts of the case, and that it did not intend to lay down a general rule applicable to all underproductive assets.[65] To be affected by this doctrine, the trustee must have the discretionary power of sale of trust assets,[66] which may be converted into a mandatory duty of sale[67] only when certain facts are present.[68] Important considerations in this situation include whether the sale price of the underproductive property would exceed its inventory value,[69] the existence of a familial relationship between the settlor and the beneficiaries,[70] and the type of asset in question.[71] Although the New York Surrogate's Court later expressed the fear that *Rowland* might force all apportionment cases to be litigated through the court of last resort,[72] its narrow application prevented this situation from materializing.

On various occasions a minority of courts have simply applied the *Rowland* rule and required apportionment because the particular trust included beneficiaries with successive interests.[73] If proven that the settlor desired the life tenant to be the principal object of his bounty,[74] an intent to allow apportion-

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60. The *Rowland* court indicated the fact that the settlor's widow was the income beneficiary had a significant effect upon its decision. 273 N.Y. at 110, 6 N.E.2d at 396.

61. *See* A. SCOTT, *supra* note 1, § 241.3.

62. *Id. Accord, In re* Bothwell's Estate, 65 Cal. App. 2d 598, 151 P.2d 298 (1944). *See* RESTATEMENT (SECOND) OF TRUSTS § 240, Comment c (1959).

63. RESTATEMENT (SECOND) OF TRUSTS, § 240, Comment d (1959).

64. This rule was discussed in *In re* Knox' Estate, 163 Misc. 264, 296 N.Y.S. 745 (Surr. Ct. 1937). The *Knox* court pointed out how closely *Rowland* verged on adopting the Restatement rule, which creates a duty to convert in all cases of underproductivity, 163 Misc. at 268, 296 N.Y.S. at 749.

65. 273 N.Y. at 110, 6 N.E.2d at 397.

66. This is contrary to the Restatement rule, which only allows specific language in the trust instrument to override the duty of apportionment. *See* RESTATEMENT (SECOND) OF TRUSTS § 240, Comment g (1959).

67. Current state statutes modeled after the U.P.I.A. set a certain percentage rate of underproductivity to trigger apportionment. See note 12 *supra.*

68. See text accompanying notes 69-71 *infra.*

69. The 1931 version of the U.P.I.A. and Florida's older unproductive estate statute, FLA. STAT. § 690.12 (1937), denied apportionment entirely if the prospective sale would result in a loss. See notes 139-142 and accompanying text, *infra.*

70. If the beneficiaries are the surviving spouse, children, or other lineal descendants of the settlor, the chances of the court granting apportionment are considerably enhanced. *See In re* Shepard's Estate, 186 Misc. 564, 59 N.Y.S.2d 803 (Surr. Ct. 1945); RESTATEMENT (SECOND) OF TRUSTS § 240, Comment g (1959).

71. See notes 78-89 and accompanying text, *infra.*

72. *In re* Knox' Estate, 163 Misc. 264, 268, 296 N.Y.S. 745, 749 (Surr. Ct. 1937).

73. *See* Furniss v. Cruikshank, 230 N.Y. 495, 130 N.E. 625, *modified per curiam,* 231 N.Y. 550, 132 N.E. 884 (1921); *In re* Rosenzweig's Estate, 4 Misc. 2d 142, 144, 148 N.Y.S.2d 371, 372 (Surr. Ct. 1955), *aff'd,* 7 App. Div. 2d 969, 183 N.Y.S.2d 992 (1st Dep't 1959).

74. See note 70 *supra. See generally* Comment, *Apportionment Between Principal and*

ment has also been found.[75] Perhaps the best example of this situation has occured where the respective life tenant and remainderman were the settlor's surviving spouse and children.[76] Some tribunals have appeared willing to grant apportionment on this basis alone, especially if the surviving spouse was equally dependent on the trust income as his or her primary source of sustenance.[77]

If the underproductive asset in question is unimproved land,[78] there has usually been little difficulty in having the asset sold and apportioned.[79] Courts have disagreed, however, where diverse assets are involved, such as mortgages,[80] insurance renewal commissions,[81] bonds in default or sold at a discount,[82] reversionary interests,[83] personal chattels,[84] and perhaps most importantly from an investment standpoint, corporate stocks.[85] Most of the early cases involving

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Income of Proceeds Derived From the Sale of Unproductive Realty Held in Trust, 40 YALE L.J. 275 (1930).

75. *In re* Rowland's Estate, 273 N.Y. 100, 110, 6 N.E.2d 393, 396 (1937).

76. For an extensive discussion of this factor in the apportionment process, *see In re* Shepard's Estate, 186 Misc. 564, 59 N.Y.S.2d 803 (Surr. Ct. 1945).

77. *See In re* Jackson, 258 N.Y. 281, 179 N.E. 496 (1932); *see also* Jordan v. Jordan, 192 Mass. 337, 78 N.E. 459 (1906), which distinguished an earlier Massachusetts case on these grounds.

78. This has been the most common type of income-deficient property. *See generally* A. SCOTT, *supra* note 1, § 241.1.

79. *Id.*

80. *See, e.g.*, San Antonio Loan & Trust Co. v. Hamilton, 155 Tex. 52, 283 S.W.2d 19 (1955). The underproductivity problem arises in this area where the trustee attempts to salvage default upon a mortgage, either through foreclosure or taking a conveyance of a substituted parcel of land or personal property. If there is no controlling trust instrument provision, courts normally will force a conversion of the mortgage into more productive property or cash, followed by apportionment along the lines of the Restatement equation at note 21 *supra*. *See* Springfield Safe Deposit & Trust Co. v. Wade, 305 Mass. 36, 39, 24 N.E.2d 764 (1940). For an example of the application of the old New York formula at note 21 *supra*, *see* Quinn v. First Nat'l Bank, 168 Tenn. 30, 73 S.W.2d 692 (1934). Because of the equitable nature of the remedy, the amounts distributed from defaulted mortgages to principal and income are subject to a great deal of judicial discretion. *In re* Spear's Estate, 333 Pa. 199, 3 A.2d 789 (1939). For an extensive discussion of the common law approach in this field, see Bailey & Rice, *supra* note 21; Note, *Apportionment By the Trustee of Unproductive Mortgage Proceeds Between Life Tenant and Remainderman*, 49 HARV. L. REV. 805 (1936).

81. *See, e.g., In re* Pennock's Will, 285 N.Y. 475, 35 N.E.2d 177, 179, *reh. denied*, 286 N.Y. 690, 37 N.E.2d 58 (1941), which is the leading case in this area. The *Pennock* case involved the right to receive commissions on renewal insurance premiums over a fifteen year period. In modifying the lower court decision, the New York Court of Appeals classified the right to commissions as "unproductive or partially productive" assets, and ordered apportionment under the Restatement method of each payment as received. In applying this system, the court followed its earlier decision in *Rowland* and extended the scope of apportionment from real to personal property. 285 N.Y. at 486, 35 N.E.2d at 181.

82. *See* Old Colony Trust Co. v. Comstock, 290 Mass. 377, 380, 195 N.E. 389 (1935); G. BOGERT, *supra* note 4, § 826; A. SCOTT, *supra* note 1, § 240.2.

83. *See generally* A. SCOTT, *supra* note 1, § 241.1, on reversionary interests.

84. The leading case determining that personalty may be considered underproductive property is *In re* Clarke's Estate, 166 Misc. 807, 3 N.Y.S.2d 60 (1938), which is discussed at notes 86-89 *infra*.

85. See notes 206-222 and accompanying text, *infra*, for a discussion of stocks as underproductive property.

personalty as income-deficient property applied a nebulous standard of "uniqueness" in determining when apportionment would be allowed.[86] One court, for example, ruled that the asset in question had to have a "peculiar and distinctive character" in order to qualify, probably to ensure that a ready market existed for the property.[87] If the asset could not be disposed of quickly, perhaps a simple surcharge remedy against the trustee would be more appropriate.[88] Notwithstanding the earlier haggling over different tests for real and personal property, modern underproductivity cases do not differentiate between them.[89]

Mayo A. Shattuck in 1940 proposed an "equitable rule"[90] as an alternative to strictly disallowing apportionment in the absence of any evidence of intent. Shattuck believed that if the settlor had failed to express his intent on the underproductivity problem in the trust instrument, it would be absurd for a court to assume that he had wanted to retain an asset producing little or no income.[91] If trust property was found to be underproductive, its allocable carrying charges[92] would be levied on the principal and the proceeds of the required sale of the asset would be apportioned unless the settlor had clearly demonstrated a contrary intent.[93] Although the common law jurisdictions never went this far, Shattuck's arguments were later endorsed by Professor Scott[94] and subsequently incorporated into the Restatement of Trusts.[95]

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86. This was the rule of *In re* Clarke's Estate, 166 Misc. 807, 3 N.Y.S.2d 60 (1938). *Clarke* concerned a valuable art collection which was the major portion of the trust corpus. Although the paintings were a solid investment for the future, they failed to produce any current income for the life tenant. The court held that they should be sold with the receipts divided among the successive beneficiaries. 166 Misc. at 812, 3 N.Y.S.2d at 65.

87. *Id.* The court carefully stated that it had established "no general rule directing an apportionment should be made as to ordinary personalty." *Id.*

88. *See* Note, *Underproductive Trust Assets in New York*, 36 ST. JOHN'S L. REV. 259, 273 (1962).

89. The *Clarke* rule was apparently abandoned in New York in *In re* Cuff's Will, 118 N.Y.S.2d 619 (Surr. Ct. 1953). Other jurisdictions also fail to distinguish between real and personal property for apportionment purposes. Equitable Trust Co. v. Kent, 11 Del. Ch. 343, 101 A. 875 (1917); Rhode Island Hosp. Trust Co. v. Tucker, 52 R.I. 277, 160 A. 465 (1932); Gate v. Hamilton Nat'l Bank, 178 Tenn. 249, 156 S.W.2d 812 (1941). Neither the U.P.I.A. nor the Restatement distinguish between them. U.P.I.A. § 12 (1962); RESTATEMENT (SECOND) OF TRUSTS § 241, Comment b (1959).

90. *See* Shattuck, *supra* note 31, at 463.

91. Shattuck stated that: "To attempt to say that the testator had any intent upon this matter, unless he clearly expresses it, is nothing short of absurd. Absurd, because when he draws his will (a) he usually has a long way to go before he dies and he is the first to believe that his will is not his final word, and (b) he doesn't even know that he will still own the piece when he dies, and (c) he can't be certain, if he should still own it, that it will ever become part of the trust at all, and (d) he has no means of knowing which of the beneficiaries will outlive him, or (e) what their wants will be when the property does become unproductive!" *Id.* at 452.

92. *See generally* G. BOGERT, *supra* note 4, §§ 802-807. *See also* FLA. STAT. § 738.03 (1979).

93. *See* Shattuck, *supra* note 31, at 463.

94. *See generally* A. SCOTT, *supra* note 1, §§ 240-241.

95. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 240-241 (1959). Professor Scott was one of the primary drafters of the Restatement provisions.

THE RESTATEMENT APPROACH

The Restatement of Trusts[96] dispensed with all of the foregoing tests of the settlor's intent and adopted a far simpler method of apportionment determination.[97] The mere fact of underproductivity now created the duty to sell,[98] based on the presumption that where a contrary express or implied intent could not be discerned from the trust instrument,[99] the settlor intended that the life tenant would benefit[100] from each of the trust assets.[101] Any property which was considered underproductive, whether so determined at the time of creation of the trust[102] or at a later date,[103] was usually sold and apportioned.[104] This procedure was mandated when the property produced "substantially less than the current rate of return on trust investments"[105] and was likely to remain income-deficient.[106]

A primary advantage of the Restatement's position is that it avoids the necessity for a case-by-case consideration of the settlor's intent.[107] The flexibility of its underproductivity standard[108] allows the life tenant to obtain apportionment fairly easily. However, if the equities of a particular fact situation substantially favor the remaindermen, courts can still deny this procedure within the guidelines of the Restatement approach.[109] One example of this situation would be where the life cestui desires to dispose of valuable paintings, which produce no current income but are unquestionably solid investments for the future. Unless he could show an immediate need for the income resulting from their sale, a request for apportionment would probably be denied.[110]

Disposition of the Underproductive Asset

Although a court might find a duty to sell, a trustee does not automatically

96. *See* RESTATEMENT (SECOND) OF TRUSTS § 241 (1959).

97. For the basic Restatement apportionment equation, see note 21 *supra*.

98. One of the earliest cases outside New York to apply this concept was Delaware Trust Co. v. Bradford, 30 Del. Ch. 277, 59 A.2d 212 (1948). *Cf.* U.P.I.A. § 12 (1962) (setting a one percent of inventory figure as the underproductivity standard).

99. Florida follows the doctrine that the terms of the trust instrument limit the trustee's powers. *See, e.g.*, FLA. STAT. § 737.402(2) (1979).

100. Several commentators have suggested that a fixed percentage trust is the best way of ensuring that the income beneficiary enjoys a reasonable return from the trust properties. See notes 266-269 and accompanying text, *infra*.

101. *See* Delaware Trust Co. v. Bradford, 30 Del. Ch. 277, 278, 59 A.2d 213, 213 (1948).

102. *See* Rhode Island Hosp. Trust Co. v. Tucker, 52 R.I. 277, 160 A. 465 (1932). *See generally* Skilton, *The Rights of Successive Beneficiaries in Unproductive Trust Assets Not Bearing Interest*, 15 TEMP. U. L. Q. 241 (1941).

103. *See In re* Rowland's Estate, 273 N.Y. 100, 6 N.E.2d 393, 395 (1937).

104. See notes 19-24 *supra*.

105. RESTATEMENT (SECOND) OF TRUSTS § 241 (1959).

106. *Id.*

107. *See* Comment, 58 MICH. L. REV. 1049, 1054 (1960).

108. See notes 12, 21 *supra*.

109. *See* Lang v. Mississippi Valley Trust Co., 359 Mo. 688, 223 S.W.2d 404 (1949).

110. This was the factual situation and result of *In re* Clarke's Estate, 166 Misc. 807, 3 N.Y.S.2d 60 (1938), which shows the potential inequity to the income beneficiary caused by the uncertain Restatement standard.

have to make an immediate sale of the property.[111] If the fiduciary is justified in postponing the prospective sale for a prudent purpose,[112] he will not be surcharged for the delay.[113] In determining the reasonableness of his actions, a court may consider such circumstances as the tax consequences of the sale,[114] the inventory value of the property,[115] the characteristics of the portfolio as a whole,[116] and the likelihood of the property's future growth in value.[117] If the income beneficiary delays in complaining about the insufficient yield from an asset, or otherwise fails to call its underproductivity to the trustee's attention, the trustee may argue laches or estoppel to avoid liability.[118]

Among states which have embraced the apportionment concept,[119] the most common approach to the sale process is that adopted by the Restatement of Trusts.[120] The underproductive asset is to be disposed of at the first reasonable opportunity and transformed through equitable conversion[121] into more acceptable trust investments.[122] Where there has been a delay in this changeover process, the net proceeds of the sale are apportioned by computing "the sum which with [simple] interest thereon at the current rate of return on trust investments from the day when the duty to sell"[123] was ascertained would equal

111. RESTATEMENT (SECOND) OF TRUSTS § 241, Comment b (1959).

112. Valid reasons for delaying disposition of the asset include lack of a market, certainty of later appreciation, and the necessity of preparing the property for sale. *See generally* Shattuck, *Do Present Day Conditions and Modern Draftsmanship Imply a New Theory of Trust Management?*, 26 TR. BULL. 17 (1947).

113. *See* A. SCOTT, *supra* note 1, § 1240, at 2056.

114. Of particular importance for federal tax purposes would be the applicability of capital gains treatment of the sale of the underproductive asset along with the effects of apportionment on the distributable net income of the trust. *See* I.R.C. §§ 643(a)(3), 661, 662, 1202, 1221, 1231. Perhaps a more advisable procedure would be a like kind exchange of the asset, thus allowing at least partial current nonrecognition of the gain realized from the disposition. *See* I.R.C. § 1031.

115. This is also an important factor in the initial determination of the existence of a duty to sell. See notes 49-52 *supra*.

116. Note that Florida's current underproductive trust property statute allows retention of an underproductive asset if the rest of the estate boosts the overall rate of return to three percent. FLA. STAT. § 738.12(1)(a) (1979).

117. *See, e.g., In re* Gross' Estate, 216 Cal. App. 2d 563, 568, 31 Cal. Rptr. 281 (1963), which looked to the original as well as the fair market value of the property. Although the land in question was underproductive as related to its then current value, it produced an income of 16% measured against its book value. The court therefore held that the prospects for future growth were good, and denied apportionment. 216 Cal. App. 2d at 568-69, 31 Cal. Rptr. at 284.

118. *See* Comment, *Trust Administration—Apportionment and Other Remedies of an Income Beneficiary When the Trustee's Retention of Unproductive Property Causes a Loss or Termination of Income*, 58 MICH. L. REV. 1049, 1061 (1960).

119. See note 12 *supra*.

120. RESTATEMENT (SECOND) OF TRUSTS §§ 240, 241 (1959). The U.P.I.A. has also embraced this theory. U.P.I.A. § 12 (1962).

121. See note 26 *supra*.

122. One such example of a common asset transformation is that of low-yield into high-yield stock. *See* Note, *Common Stocks in Trust*, 113 U. PA. L. REV. 228, 238 (1964).

123. *See* A. SCOTT, *supra* note 1, § 241. The U.P.I.A. has maintained the extremely low required yearly income productivity standard of one percent of inventory value. U.P.I.A. § 12 (1962). In some circumstances involving relatively low valued trusts, this amount could approach *de minimus* proportions for the life tenant. *See* Note, *Common Stocks in Trust*, 113

the amount realized from the sale.[124] This sum would then be allocated to the trust principal, with the residue going to the income beneficiary.[125]

An important facet of this system is that the burden of paying certain expenses incurred in retention and sale of the underproductive property may be shifted between income and corpus.[126] Insurance costs and real estate taxes, usually a drain on the life tenant,[127] are initially charged to principal.[128] The trust source which had been responsible for carrying charges during the asset's holding period is reimbursed from the sale proceeds,[129] and related costs such as attorney's fees and broker's commissions are similarly delegated.[130]

Although the income beneficiary does receive a degree of pecuniary benefit from the sale and apportionment of the underproductive asset, this remedy is not completely satisfactory. The life tenant must depend upon the trustee's ability to locate a sometimes nonexistent market for the property.[131] An added disadvantage is the possible delay before final disposal.[132] Notwithstanding these

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U. PA. L. REV. 228, 237 (1964). Florida's current law uses a three percent level, FLA. STAT. § 738.12(1)(a) (1979), in comparison with the 1975 statute's two percent amount. FLA. STAT. § 728.12(1) (1975).

124. RESTATEMENT (SECOND) OF TRUSTS § 241, Comment i (1959).

125. *Id. Cf. In re* Chapal's Will, 269 N.Y. 464, 199 N.E. 762 (1936) (illustrating the more complex New York pro-rata approach applied to mortgages in default as underproductive property). Apportionment in this area often amounts to a salvage operation because the trustee is usually the buyer in resulting foreclosure sale. *See, e.g., In re* Otis' Will, 276 N.Y. 101, 11 N.E.2d 556 (1937). Under the pro-rata method, the net proceeds are allocated between principal and income in the ratio which the principal sum due of the mortgage bears to the interest payable. *See* Bailey & Rice, *supra* note 21. The results of this system differ from those attained under the Restatement only where the mortgage's interest rate is not that of the current trust rate. *Id.*

The most significant problems associated with the New York approach involve unfairness to the remainderman. First, by following the mortgage's interest rate, the income beneficiary could conceivably be awarded a higher level of return than that of the standard trust investment. The court in *In re* Bothwell's Estate, 65 Cal. App. 2d 598, 151 P.2d 298 (1944), recognized this potential windfall and named this as one reason for choosing the Restatement method instead. *Id.* at 610-11, 151 P.2d at 305-06. Secondly, the mortgage rate has been held applicable under the New York method even where the foreclosure sale has already taken place. This situation harms the future beneficiary because he may lose from the principal the difference between the expected interest rate and that actually derived from the sale. *See generally* Comment, *Determination of the Respective Interests of Life Tenant and Remainderman in the Proceeds of an Unproductive Mortgage*, 24 VA. L. REV. 572 (1938).

Texas and New Jersey have also followed the pro-rata approach. *See* Hudson County Nat'l Bank v. Woodruff, 122 N.J. Eq. 444, 194 A. 266, *modified*, 123 N.J. 585, 199 A. 399 (1937); San Antonio Loan & Trust Co. v. Hamilton, 155 Tex. 52, 283 S.W.2d 19 (1955).

126. RESTATEMENT (SECOND) OF TRUSTS § 241(3) (1959).

127. *See, e.g.*, FLA. STAT. § 738.13(1)(a) (1979).

128. *See, e.g., In re* Cronise's Estate, 167 Misc. 310, 316, 6 N.Y.S.2d 392, 399 (Surr. Ct. 1937).

129. RESTATEMENT (SECOND) OF TRUSTS § 241, Comment h (1959). *See also In re* Chapal's Estate, 161 Misc. 67, 292 N.Y.S. 663 (Surr. Ct. 1934).

130. Although under FLA. STAT. § 728.13(1)(a) (1979) the income beneficiary seems to be slighted because selling expenses are normally paid from the principal, this switch from principal to sales proceeds appears reasonable, because the sale was forced for his benefit.

131. For an example of the problems involved, see the discussion of the blockage question in stock disposal in *In re* Estate of Bayles, 108 N.J. Super. 446, 459-60, 261 A.2d 684, 691 (1970).

132. A particularly perplexing related issue is the allocation of stock dividends between

drawbacks, most states still embrace the concept of apportionment as a statutory means of providing the life tenant with some solace.[133]

The Former Florida Approach: The Uniform Principal and Income Act

In 1937, Florida adopted verbatim as its first statute in this area the Uniform Principal and Income Act provision pertaining to an "unproductive estate."[134] The 1937 law applied a set percentage to determine underproductivity, a major change from the Restatement and common law method of calculating income deficiencies on a case-by-case basis.[135] In order to create a duty to sell, the asset under scrutiny after 1931 had to produce an average net income of less than one percent per annum of its inventory value.[136] This standard constituted a vast improvement over the nebulous common law approach,[137] but the low rate chosen as the base amount often failed to aid the income beneficiary sufficiently. When applied to relatively small dollar value properties, the one percent return standard constituted so niggardly a return as to almost reach the *de minimus* level.[138]

A major problem with the old Florida law was its failure to permit apportionment of property sold at a loss.[139] The income beneficiary could only receive as his share of the sales receipts the excess paid over the inventory value.[140] If this amount was unascertainable, he was entitled to the figure obtained by subtracting from the net sale proceeds the asset's fair market value at the time of the creation of the trust or its cost if purchased later.[141] In contrast, the common law doctrine deemed both the selling price of the property and its value upon receipt by the trustee as completely immaterial so that the entire sales proceeds were apportioned.[142]

Contrary to the traditional rule, the statute created a rebuttable presump-

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corpus and income during the interim period prior to sale. *See* Wells, *Pity the Poor Income Beneficiary: How to Reconcile Growth and Yield?*, 103 TR. & EST. 119 (1964).

133. Apparently, of the thirty-six states adopting either the 1931 or 1962 versions of the U.P.I.A., only Florida has rejected its apportionment procedure. *See* U.P.I.A., Table of Jurisdictions (1931) (1962).

134. FLA. STAT. § 690.12 (1937). This was the law in Florida until June 1, 1975, when FLA. STAT. § 738.12 (1975) became effective.

135. *See* Wallace v. Julier, 147 Fla. 420, 3 So.2d 711 (1941); RESTATEMENT (SECOND) OF TRUSTS § 241, Comment l (1959).

136. FLA. STAT. § 690.12(1) (1937). *See also* U.P.I.A. § 11(1) (1931).

137. The Restatement applies the common law standard of "substantially less than the current rate of return on trust investments." RESTATEMENT (SECOND) OF TRUSTS § 241 (1959).

138. *See* Burd, *The Uniform Principal and Income Act: A Plea for Uniformity*, 109 TR. & EST. 762, 763 (1970).

139. FLA. STAT. § 690.12(2) (1937) stated that "in no event shall such income be more than the amount by which the net proceeds exceed the inventory value of the property or in default thereof its market value at the time the principal was established or its cost where purchased later."

140. *Id.*

141. *See* A. SCOTT, *supra* note 1, § 241A.

142. *See, e.g.*, Lawrence v. Littlefield, 215 N.Y. 561, 564, 109 N.E. 611 (1915).

tion that the duty to sell[143] first arose one year after either the date the trustee received the property as underproductive, or the time the asset subsequently became so deficient.[144] This provision illustrated the worst aspect of Florida's old apportionment method because the life cestui lost the equivalent value of one year's income from the underproductive asset even if its sale was later mandated.[145]

The only Florida underproductive property case,[146] *In re Russell's Will*,[147] dealt with this limitation on the right of the income beneficiary to gain a more equitable share of the apportioned funds. An Orlando bank serving as personal representative of the estate and trustee of its testamentary trust sought a declaratory judgment regarding the applicability and interpretation of section 690.12, Florida Statutes.[148] The trust consisted of one parcel of real property which produced little or no income, and all the interested parties had stipulated that the land was underproductive for the purposes of the above statute.[149] At issue was the date from which the duty to sell the trust asset commenced: September 7, 1967, the date the bank received letters testamentary; August 31, 1968, one year after decedent's death; or August 7, 1970, when the bank qualified as trustee.[150]

The *Russell* court noted that under Florida law "personal representative" could be substituted for "trustee" in the state's Principal and Income provisions,[151] and that a personal representative takes possession of the estate's real property upon issuance of letters.[152] Therefore, the court held the duty arose on September 8, 1968.[153] If the court had adopted the remainderman's argument that the qualifying date of the trustee was so applicable, the decedent's daughter, as the life tenant, would have lost nearly three years of income.[154]

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143. See notes 25-30 *supra* for a discussion of the general duty to sell.

144. FLA. STAT. § 690.12(3) (1937).

145. *See, e.g., In re* Russell's Will, 40 Fla. Supp. 117 (Orange County Cir. Ct. 1974).

146. The reason for this scarcity of case law is unknown and rather perplexing, because Florida has now had an underproductive property statute for sixty-two years. Other states which, like Florida, also have a great deal of trust activity, such as New York and Massachusetts, have been faced with much more judicial activity in this area. *See generally* Younger, *supra* note 7. The probable reasons for the lack of Florida cases are the tremendous latitude granted by the legislature to the fiduciary, FLA. STAT. §§ 690.12, 737.402 (1979), and the ease with which the statutes could be satisfied because of their low (1-3%) expected rates of return. *See, e.g.*, FLA. STAT. § 738.12 (1975); FLA. STAT. § 738.12 (1979).

147. 40 Fla. Supp. 117 (Orange County Cir. Ct. 1974).

148. Note that *Russell* was decided less than one year before the underproductive property statute was completely revised. A different result may have been reached under FLA. STAT. § 738.12 (1975).

149. 40 Fla. Supp. at 119 (Orange County Cir. Ct. 1974).

150. *Id.*

151. Circuit Judge George N. Diamantis held that FLA. STAT. § 733.011 (1974) of the Florida Probate Code stated that for decedents' estates entered into probate after July 1, 1965, "personal representative" and "trustee" were synonymous for the purposes of Chapter 690 of the Florida Statutes. *Id.*

152. *Id. See* FLA. STAT. §§ 733.401, 733.612 (1979).

153. 40 Fla. Supp. at 120 (Orange County Cir. Ct. 1974).

154. If the qualifying date of August 7, 1970, had been applied by the court, any rights

The ultimate result of *Russell* is justified as mitigating the harsh consequences of the statutory presumption, especially in the common situation where a private individual or corporate entity acts in both fiduciary capacities.[155] In such a case, no excuse exists for delaying sale and apportionment because underproductive property could be identified as such immediately upon its receipt by the estate.[156] Notwithstanding the carefully formulated reasoning in *Russell*, the state legislature decided one year later to revamp totally the Florida system of dealing with underproductive property.

The 1975 Innovation: Yearly Payment of Substituted Income

In 1975, as part of the complete revision of the probate and trust sections of the Florida Statutes,[157] the legislature departed from the common law and Uniform Principal and Income Act's delayed sale and apportionment doctrine by enacting a statute requiring yearly reimbursement of the life tenant by the trustee.[158] Underproductive property was redefined as any portion of the corpus held for appreciation which failed in any year to yield a net income of two percent of its inventory value.[159] At the close of the trust's fiscal year, the trustee had to pay the income beneficiary, using the quickest available cash source of the trust corpus, an amount equal to four percent of the inventory value of the asset.[160] The life tenant was also reimbursed for any related carrying charges previously paid from income less any income received and the value of any beneficial use of the property by the income beneficiary in that year.[161] However, courts could no longer force the sale of the asset. If the underproductive property was disposed of, the income beneficiary was only entitled to the amounts unpaid under the percentage requirement.[162]

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to lost income for the time period between the September 7, 1967, letters issuance date and the former date would not have been recognized.

155. Quite often a corporate or private trustee will "wear both hats" in this manner in order to save time and money, along with theoretically best serving the needs of the estate and its related testamentary trust. For an example of the problems involved with underproductive stock as trust property where one entity fills both positions, *see In re* Estate of Beach, 41 Cal. App. 3d 774, 116 Cal. Rptr. 418 (1974), *aff'd as modified*, 542 P.2d 994, 125 Cal. Rptr. 570 (1975).

156. FLA. STAT. § 733.607 (1979) prescribes the proper steps for the personal representative's collection of the estate assets, and in conjunction with FLA. STAT. § 733.608 (1979), shows that he may quickly assemble and examine the involved property and discern its income-production nature and potential.

157. Chapters 733 and 737 of the Florida Statutes, relating to administration of estates and trusts, were both subjected to extensive modifications. *See generally* Fenn & Koren, *The 1974 Florida Probate Code—A Marriage of Convenience*, 27 U. FLA. L. REV. 1 (1974).

158. *See* FLA. STAT. § 738.12 (1975).

159. *Id.* § 738.12(1).

160. *Id.* § 738.12(1)(a)-(b).

161. *Id.* Note that these provisions for yearly income payment to the life cestui are very similar to the equivalent amounts provided under the revised U.P.I.A. rule of apportionment. *See* U.P.I.A. § 12 (1962).

162. FLA. STAT. § 738.12(2) (1975) stated that "[u]pon the sale of the property the income beneficiary shall not be entitled to any portion of the proceeds of sale, except that any

Courts[163] and commentators[164] have long stated that yearly income payments in lieu of apportionment would be impractical and unfair to both successive beneficiaries. By distributing current funds rather than waiting for a sale, the amount of the income would depend solely on an estimation of the value of the underproductive asset, which later might be sold for a much higher or lower price.[165] In addition, the remainderman's interest is decreased by the payments out of corpus.[166]

However, these contentions are adequately countered by legislative provisions and practical realities. Through the abolition of a remedy dependent upon sale, the trustee is relieved of the onerous burden of handling the complex system of allocation of the resulting proceeds between the successive beneficiaries.[167] The statutory percentage rate of required return[168] insures that the life cestui receives an equitable distribution, rather than having to rely upon the speculative market.[169] The remainderman can also benefit because the income beneficiary might be accepting a lower yield than he would have gained under apportionment, therefore providing funds towards the retention of the underproductive asset.[170] The future taker would in this manner be relieved of

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amount determined in subsection (1) that remains unpaid at the time of sale shall be paid therefrom."

163. The leading case espousing this concept is *In re* Winthrop's Estate, 168 Misc. 861, 6 N.Y.S.2d 539 (Surr. Ct. 1938). The trust estate therein included $50,000 in cash and liquid securities and $390,000 of bonds in default. The court denied the income beneficiary's request that some of the trust's liquid assets be sold, with the proceeds split between principal and income in anticipation of the prospective disposal and apportionment of the underproductive bonds. The life tenant was given rights to such proceeds only after actual sale. The court stated, "It would introduce an unprecedented and dangerous element into the administration of estates if liquid assets could be devoted to income payments because other capital assets do not pay interest currently .... *There is no warrant for apportionment until there are proceeds to be apportioned.*" (emphasis in original) *Id.* at 863, 6 N.Y.S.2d at 541.

164. *See, e.g.*, A. SCOTT, *supra* note 1, § 241.1.

165. Because underproductive assets are often quite difficult to sell on the open market, it may be extremely hard to place a definite fair market value on such property. However, a Florida trustee still should be under a burden to act prudently to dispose of the asset as quickly as possible in order to mitigate the resulting drain on the principal. The spectre of a surcharge may help override any of the fiduciary's fears of insufficient sales proceeds. *See* FLA. STAT. §§ 518.11, 737.302 (1979). Unfortunately, the current underproductive property statute, FLA. STAT. § 738.12 (1979), does not clearly indicate the extent of this duty of speedy conversion, which the proposed statute in the Appendix attempts to rectify. See Appendix, *infra*.

166. However, if the trustee fails to ameliorate this situation within a reasonable period of time, he could be subject to surcharge by the remainderman. *See* A. SCOTT, *supra* note 1, § 231.

167. See note 21 *supra* for the types of apportionment allocation formulas most often adopted.

168. See notes 159-162 and accompanying text, *supra*. The current statute now uses a dual three percent standard for both required productivity and yearly substituted income. FLA. STAT. § 738.12(1)(a) (1979).

169. See notes 26, 165 *supra*.

170. One commentator has argued a similar justification exists for his system of "anticipatory apportionment" of stock proceeds. Aronstein, *Toward Growth With Fair Return*, 104 TR. & EST. 788, 789 (1965). The income beneficiary would be allocated the amount by which the interest from a selected alternative bond investment exceeds his dividend income. *Id.* This

his normal burden of paying the asset's carrying charges.[171]

The advantages of the yearly substituted income method[172] greatly outweigh any potential difficulties. Unless the trust instrument expressly provides otherwise, the life tenant is presumed to be the natural object of the settlor's bounty,[173] and should be entitled to a steady flow of income.[174] Florida courts have traditionally maintained that even where the settlor has directed that the trustees have "absolute discretion" in allocating trust receipts between income and principal, this broad fiduciary power must be exercised to insure that adequate provisions are made for each successive beneficiary.[175] In uncertain cases, the interests of the life tenant are to be preferred over those of the remainderman.[176] The old apportionment statute,[177] which was unusable by the suffering income beneficiary in most situations,[178] has been replaced by a law which allows the judicial system to exercise this sympathetic policy fully for the first time.[179]

The 1977 Revisions: A Giant Step Backward

In 1977, the Florida legislature without much fanfare or consideration[180]

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method limits the amount of related distributable income in any one year to such funds as the trust could actually have realized, and prevents the remainderman from obtaining all of the appreciation benefits. *Id. See also* Note, *Common Stocks in Trust*, 113 U. PA. L. REV. 228, 252-55 (1964). Note that the system applied above is that used in *In re* Wehner's Will, 238 Wis. 557, 300 N.W. 241 (1941), which is extensively discussed at notes 210-222 and accompanying text, *infra*.

171. *See* FLA. STAT. § 738.13(3)(b) (1979). *See also* Delaware Trust Co. v. Bradford, 30 Del. Ch. 277, 59 A.2d 212 (1948).

172. This system is so labeled because it provides current funds to the income beneficiary in amounts similar to those which he would have received if either the underproductive asset had been sold and apportioned, or if the property had produced a reasonable rate of return.

173. *See* Early, *Adventures in the New Principal and Income Law*, 50 FLA. B.J. 542, 542-44 (1976). Early contended that "[t]he new [1974-75] law [was] a substantial improvement over the old" and was "at almost every juncture income-oriented," *id.*, but expressed a somewhat ambivalent attitude towards certain provisions, including FLA. STAT. § 738.12 (1975).

174. FLA. STAT. § 738.12 (1975) provided for a four percent current income payment, which was amended in 1977, for no apparent reason, to three percent. FLA. STAT. § 738.12(1)(a) (1979). Regardless, both of these amounts are too low to ensure a reasonable return. See note 283 and accompanying text, *infra*.

175. Florida strongly supports this doctrine. *See, e.g.*, Wallace v. Julier, 147 Fla. 420, 3 So. 2d 711 (1941).

176. *Id.* at 437, 3 So. 2d at 717.

177. FLA. STAT. § 690.12 (1937).

178. Most underproductive property dispositions resulted in a net loss, rendering the 1937 statute inapplicable. See notes 139-142 and accompanying text, *supra*.

179. *See* Wallace v. Julier, 147 Fla. 420, 436, 3 So. 2d 711, 717 (1941).

180. The amendments to FLA. STAT. § 738.12 (1975) were slipped in as part of a Senate bill modifying FLA. STAT. § 738.04(2) (1975). Representatives Frank and Richmond added these changes to the underproductive property statute after the general bill had already passed the Florida House and Senate Judiciary Committees. As so amended, the bill passed both houses without dissent and was approved by then-Governor Askew as ch. 77-254, Laws of Florida (current FLA. STAT. § 738.12 (1979)) on June 6, 1977, with an effective date of October 1, 1977.

amended its yearly substituted income approach in a manner potentially disastrous to the interests of the life tenant. Although the drafters of the statute threw a small bone to the income beneficiary by raising the definitional underproductivity percentage from two to three percent per annum,[181] they effectively snatched it back through other modifications. The 1975 statute had specified that underproductive property was to be treated on an individual asset basis,[182] but the 1977 law is triggered only if the *total principal* of the trust does not in any given year yield the set percentage of net income.[183] In addition, the amount to be paid has been lowered from four to three percent of inventory value,[184] and carrying charges which have been paid out of income apparently will no longer be reimbursed.[185] Therefore, the current statute requires a significantly lower current income return than did its immediate predecessor,[186] and puts much less pressure on the trustee to satisfy the needs and desires of the life tenant.[187]

Under the new total property concept,[188] the fiduciary could retain an asset paying no yearly income which constitutes half the trust estate so long as the other half produces a six percent return.[189] By permitting an overall fund solution to cover for an underproductive asset, the 1977 amendments may contravene the accepted standard that a trustee may not offset losses with gains.[190]

See HISTORY OF LEGISLATION, *1977 Regular Session, Florida Legislature*, Fla. S. 212 (Reg. Sess. 1977, introduced by S. Sayler).

Because the amendments to § 738.12 were so hastily pushed through the legislature, it is possible that some of the weaknesses of the resulting statute were caused by misunderstandings or oversights. For example, the 1979 law inexplicably deletes the "less any income received" language of FLA. STAT. § 738.12(1)(b) (1975). FLA. STAT. § 738.12(1)(a) (1979). If the current statute's literal language is followed, it would permit the life tenant to receive any income return up to three percent during the year if that figure is not reached, *and* a three percent reimbursement of "lost" income at the end of the year. Although this result is clearly not what the legislature intended, it would result in a more reasonable level of yearly payments to the income beneficiary. See notes 280-283 *infra*.

181. *Compare* FLA. STAT. § 738.12(1) (1975) *with* FLA. STAT. § 738.12(1)(a) (1979).

182. FLA. STAT. § 738.12(1) (1975) stated "If *any portion* of the principal . . . ." (emphasis added).

183. FLA. STAT. § 738.12(1)(a) (1979).

184. *Compare* FLA. STAT. § 738.12(1)(b) (1975) (4%) *with* FLA. STAT. § 738.12(1)(a) (1979) (3%).

185. The specific clause pertaining to payment of carrying charges in the 1975 statute, FLA. STAT. § 738.12(1)(a) (1975), was entirely deleted as part of the 1977 revisions. FLA. STAT. § 738.12 (1977).

186. *See* notes 160-162 and accompanying text, *supra*.

187. The 1977 modifications do include one minor benefit for the income beneficiary, however. FLA. STAT. § 738.12(1)(b) (1979) requires the trustee to pay the life cestui his three percent share on a pro-rata basis in trusts which terminate in less than twelve months.

188. FLA. STAT. § 738.12(1)(a) (1979) refers to the "total principal of a trust." *Cf.* FLA. STAT. § 738.12(1) (1975) ("any portion of the principal").

189. *But see* FLA. STAT. § 518.11 (1979), the "prudent man rule," which almost certainly would hold the fiduciary open to a surcharge action by the income beneficiary if he attempted to take advantage of the statute in this manner.

190. *See* A. SCOTT, *supra* note 1, § 213.1. If a fiduciary makes several investments which eventually become income-deficient, he may attempt to reduce the amount of his potential surcharge liability by creating a wash situation with more profitable investments. *Id.* The life

Even if other high-yielding investments were purchased to counteract the deficient asset, such a financial planning procedure would be improper because there could be a corresponding decrease in corpus along with the higher return due to the unstable value of such properties.[191]

The new provisions have a potentially significant effect upon the trustee's duty to prudently manage and invest the trust's assets, because the balancing income-source concept inherent in the statute apparently negates the common law duty to sell underproductive property.[192] However, both common sense and practical considerations demand that a trustee exercise his fiduciary responsibilities by disposing of such an asset through the most efficient means possible, while still obtaining the highest price the market will pay.[193] The fact that an institutional trustee's fee for property management is normally based in part upon a certain percentage of the income produced by each trust asset may be a sufficient impetus in this regard.[194] The traditional disposition requirement probably will withstand the confusion created by the statute, but the legislature should have prevented this problem from arising through clearer language and more graphically delineated guidelines.

COPING WITH UNDERPRODUCTIVE TRUST PROPERTY

A fiduciary managing a testamentary trust under the current Florida statute has very few settled principles to follow in attempting to handle underproductive assets. No Florida judicial interpretation of the common law or Restatement solutions exists.[195] The concept of yearly payment of income as an alternative to apportionment has not been adopted by any other state.[196] Therefore, the history of a similar statute is unavailable for comparison. However, the reasoning used by courts applying the apportionment remedy and the recom-

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tenant can instead accept the reasonably productive assets and hold the trustee liable for the losses incurred on the others. *Id.* For a typical trust situation involving both high and low-yield securities where the above rule was applied, see Creed v. McAleer, 275 Mass. 353, 175 N.E. 761 (1931). This concept also should operate to block any attempt to "hide" an underproductive asset in a common trust fund. *See generally* FLA. STAT. §§ 660.11-.14 (1979).

191. This becomes especially important when the wildly fluctuating corporate stock or government bond markets are utilized for such a purpose. As for even more speculative investments, such as oil or mining operations, Professor Scott has stated that "[t]he common element in the case of all such property is that its value will necessarily depreciate or be destroyed." A. SCOTT, *supra* note 1, § 239.

192. See notes 19-24 and accompanying text, *supra.*

193. *See* FLA. STAT. §§ 518.11, 737.302 (1979).

194. Barnett Banks Trust Company, N.A., for example, charges as part of its fee for management of income-producing real estate held in a testamentary trust five percent of the yearly gross income so derived. *See* Barnett Banks Trust Company, N.A., Barnett Testamentary Trust Services and Fees (1974).

195. In the only Florida case involving underproductive trust property, *In re* Russell's Will, 40 Fla. Supp. 117 (Orange County Cir. Ct. 1974), the court stated "[t]hese [common law] authorities are not applicable since they do not involve the Uniform Principal and Income Law which is Chapter 690, Florida Statutes, and, more importantly, do not deal with the Florida Probate Code . . . ." *Id.* at 120.

196. The states embracing the U.P.I.A. provisions have jurisdictional law closest to that of Florida, but each of those retains the apportionment method. See note 12 *supra.*

mendations of legal scholars may be used to illustrate how a trustee should react when confronted with certain types of income-deficient property.

Perhaps the most frequent situation involving underproductivity occurs when the asset in question is unimproved land or an empty residential or business structure.[197] If the trustee cannot successfully sell the property or improve his position through a like kind exchange,[198] he can attempt to provide current income through renting the property.[199] Long-term leases of otherwise underproductive buildings have been permitted as an effective means of obtaining funds for the income beneficiary.[200] Extended-period rental contracts with or without options to renew or purchase ordinarily bring the greatest return,[201] and a Florida trustee is expressly granted by statute the power to enter into such agreements.[202] Even if the settlor has stated in the trust instrument that certain properties cannot be leased for over one year, under certain circumstances a court may ignore this stipulation and allow long-term rental for the benefit of the trust's life cestui.[203] However, Florida's general reliance on the trust instrument as the final determinant of the fiduciary's powers indicates that it would be unlikely for a Florida court to take this approach.[204]

If the fiduciary is confronted with a trust estate consisting of underproductive personal property and choses in action, the current Florida statute appears to mandate either diversification through reinvestment in higher-yielding sources of income or some other means of increasing yearly cash output.[205] Perhaps the most common related problem faced by the trustee involves growth

197. See note 78 *supra*.

198. This tax-saving procedure may be preferable for assets which satisfy the provisions of I.R.C. § 1031. *See generally* Commissioner v. Crichton, 122 F.2d 181 (5th Cir. 1941); TREAS. REG. § 1.1031(d)-1 (1979).

199. Although a Florida fiduciary does have the power to mortgage real property held by the trust under FLA. STAT. § 737.402(2)(g) (1979), courts are highly reluctant to permit this procedure unless the trustee is specifically authorized to so act by the trust instrument. *See, e.g.*, Baum v. Corn, 167 So. 2d 740 (Fla. 2d D.C.A. 1964). Leasing is a much more preferred practice. *Compare* Russell v. Russell, 109 Conn. 187, 145 A. 648 (1929) (common law power to rent) *with* FLA. STAT. § 737.402(2)(k) (1979) (legislatively-granted leasing power).

200. *See In re* Menzel's Will, 247 Minn. 559, 567-68, 77 N.W.2d 833, 839 (1956). The *Menzel* court allowed an existing ninety-nine year lease to be extended through options to April 30, 2105, stating that "long-term leases are necessary in order to induce investments of large sums of money in improving and maintaining valuable commercial structures . . . . But it seems to us the most compelling consideration here is that the beneficiaries and remaindermen will receive substantial and immediate benefits from the proposed extension. The existing terms of the lease as to rent are so disadvantageous as to deprive the beneficiaries of the full benefits intended by the settlor. The disparity between the rent received and the actual rental value of the property defeats in large measure the purpose of the trust." *Id.* at 568, 77 N.W.2d at 839. *But see* Cambell v. Kawananakoa, 31 Haw. 500 (1930), which espouses the opposing minority view.

201. *Id. See also* G. BOGERT, *supra* note 4, § 792.

202. *See* FLA. STAT. § 737.402(2)(k) (1979).

203. *See* Colonial Trust Co. v. Brown, 105 Conn. 261, 285-86, 135 A. 555, 564 (1926), where the court invalidated the settlor's stipulation that his valuable business property located in the downtown Waterbury business district not be leased for periods exceeding one year on "public policy" grounds.

204. *See, e.g.*, FLA. STAT. § 737.402(2) (1979).

205. *See* FLA. STAT. § 518.11 (1979).

stocks[206] and savings bonds[207] as the primary or sole trust corpus assets. Stock holdings of such publicly-held corporations as Xerox and Sperry Rand may be excellent investments in terms of stability and future increases in value, and thereby satisfy the trust's remaindermen.[208] However, this type of stock frequently pays low dividends,[209] which slights the interests of the income beneficiary.

If the trustee does not wish to sell the stocks or bonds immediately, he can petition a Florida court to grant him the ability to apply "anticipatory apportionment"[210] as a corrective measure for the asset's income-deficiency. This concept was originally applied in the Wisconsin case of *In re Wehner's Will*[211] to permit retention of a United States savings bond which did not pay its maximum interest rate until its redemption date.[212] The court accepted the trustee's novel argument that the trust could employ its liquid assets to "purchase" the income beneficiary's interest in the increasing value of the bond.[213] Instead of receiving his portion of the accumulated interest after an extended waiting period, the life tenant would be provided with a yearly pro-rata share of the accrued earnings.[214] Through the application of the *Wehner* rule, both successive beneficiaries enjoy the benefits of long-term appreciation, and the fiduciary can maintain current income production while preserving principal.[215]

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206. This type of corporate security is generally characterized by a solid historical background, excellent future prospects for expansion and increase in value, and relatively low yearly dividend payments due to the continuing desire to reinvest earnings in the company. *See generally* Aronstein, *supra* note 170; Duncan, *Trustee Dilemma—What to Do About Growth Stocks?*, 100 TR. & EST. 533 (1961). Two such stocks are Esmark, Inc. and the McDonnell Douglas Corporation. *See* MOODY'S HANDBOOK OF COMMON STOCKS (1st Q. ed. 1979).

207. This note is primarily concerned with the common United States Series "E" savings bond, involved in *In re* Wehner's Will, 238 Wis. 557, 300 N.W. 241 (1941).

208. *See generally* MOODY'S HANDBOOK OF COMMON STOCKS (1st Q. ed. 1979).

209. *See* note 204 *supra.*

210. This is the label applied to such activity by Aronstein, *supra* note 170, at 789.

211. 238 Wis. 557, 300 N.W. 241 (1941).

212. The bonds involved in *Wehner* were redeemable at their full annual interest rate of 2.9% only if held for the full ten years of their lives. If early redemption was desired, a lower rate of 1.33% to 2.84% was applied according to a graduated schedule. *Id.* at 557, 300 N.W. at 241.

213. The court explained this reasoning by stating that "[i]n this case the trustee had funds belonging to the corpus on hand. The trustee proposed to invest these funds and to purchase from the life tenant the [bond] interest due the life tenant. The fund thus expended would be restored to the corpus whenever the bonds were matured or were redeemed." *Id.* at 559, 300 N.W. at 243.

214. *See In re* Wehner's Will, 238 Wis. 557, 558, 300 N.W. 241, 242 (1941) for the table used by the Supreme Court of Wisconsin in determining the payment to be distributed annually to the income beneficiary.

215. The *Wehner* court explained, "[h]ere is a security admittedly as good as any which would be purchased in the market and bearing a higher rate of interest than any other security equally as good . . . . [B]y investing the corpus in the interest earned but not payable, which belongs to the life tenant, the funds belonging to the corpus are placed in an absolutely safe investment and the income is made available to the life tenant . . . . This plan makes the United States Savings Bonds a practical and workable form of investment for trust funds in a manner which assures the life tenant a steady flow of income while at the same

The revised Uniform Principal and Income Act and at least ten states have now adopted the anticipatory apportionment rule.[216]

Although the *Wehner* remedy was prescribed for those jurisdictions using the apportionment method of curing underproductivity, the rule could be readily applied to solve the problems of a Florida fiduciary if his trust has other corpus assets which can be easily converted into cash. Such liquid properties could then be sold in order to pay off the life cestui in accordance with the statutory three percent minimum income level,[217] the principal being reimbursed upon future sale or redemption of the underproductive asset.[218] If this method is accepted in Florida, it need not be limited to certain stocks[219] and savings bonds.[220] Potential subjects for the *Wehner* procedure include many types of trust properties used as hedges against inflation through long-term retention: works of art, antiques, collector's items, certificates of deposit, and vacant real property.[221] Through a careful balancing of liquid and growth assets, a judicious trustee could thereby apply the anticipatory apportionment doctrine to support his otherwise prudent decision to retain a trust asset.[222]

Trust Instrument Provisions: Protection of the Trustee

Specific language in the trust document most effectively averts any potential problems which the fiduciary may confront during the administration of a trust.[223] However, all difficulties related to underproductive property cannot be

time keeping the funds of the remainderman safely invested in a security of the highest type available in any market." *Id.* at 562, 300 N.W. at 243.

216. *See* Barclay, *Lot of Income Beneficiary: Remedies*, 104 TR. & EST. 277, 278 (1965).

217. FLA. STAT. § 738.12(1)(a) (1979).

218. See note 170 *supra.*

219. Growth stocks would be ideal candidates for the *Wehner* procedure. See notes 170 and 204 *supra.* However, such stocks as Resorts International and small mining companies would probably face too uncertain a future to be viable for anticipatory apportionment. See note 93 *supra.*

220. See note 207 *supra.*

221. Each of these items as a trust asset would probably be subject to a steady growth in value ahead of or in line with the rate of inflation. Any collector's item also generally enjoys high liquidity and can be valued through appraisal or the numerous published guidebooks. Under most circumstances, their projected sales prices are reasonably ascertainable, which allows the fiduciary to apply the *Wehner* formula to make the proper yearly payments to the life tenant. *See* Etelson, *The Dealer's Viewpoints: Appraisal and Disposal of Works of Art*, in COLLECTORS AND ARTISTS, PLANNING AND PROBATING THE ESTATE (1978). *See also* Boling, *Administering Collectible Stamps*, 118 TR. & EST. 9 (1979). With savings certificates, the current high rate of inflation has made them attractive high-yield investments, paying over 12%. *See* N.Y. Times, November 1, 1978, § B, at 2, col. 1.

222. Perhaps the ideal mixture for trust diversification purposes would be a combination of corporate stocks, valuation personal properties, and both improved and vacant real property. If necessary, mutual funds may be kept as a stable corpus item. *See generally* Note, *Common Stocks in Trust*, 113 U. PA. L. REV. 228 (1964). For an excellent discussion on the creation of a "market" or "index" fund, which is a stock portfolio providing built-in trust asset diversification through the inclusion of different types of securities, see Langbein & Posner, *The Revolution in Trust Investment Law*, 62 A.B.A.J. 887 (1976).

223. The trust instrument in general overrides any statutory or common law provisions. *See* FLA. STAT. § 737.401 (1979).

foreseen by the settlor. Nevertheless, a skilled draftsman could apply several proposed techniques to ensure that income-deficient assets will be dealt with properly.

The settlor's primary intent may be to shield his trustee from liability for underproductive property.[224] The grantor may desire that certain assets remain in the ownership of his family[225] because he feels that particular types of property will be better investments,[226] or that above all other considerations a personal friend must be protected.[227] If the settlor so chooses, he may achieve this goal through various courses of action.

One method the draftsman could apply to block breach of fiduciary duty suits[228] against the trustee by the income beneficiary is a trust provision stating that there is no duty to sell income-deficient property.[229] A Florida court has the power to mandate deviation from such language if the burden on the life cestui is too great,[230] but would generally follow the express terms of the instrument.[231] As an example of a "no duty" stipulation, the settlor could provide that the fiduciary has the power to purchase low or no-dividend paying growth stocks without regard to their failure to produce current income.[232] To safeguard the life tenant's interests, the trustee should also have a coinciding duty to invade corpus for the income beneficiary if the remainder of the trust assets fails to generate enough yearly funds.[233]

A discretionary trust is another potential vehicle for obtaining this result.[234] The trustee would have the power in his "absolute discretion"[235] to determine how all receipts and expenses should be credited, charged, or apportioned be-

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224. For an example of this reasoning, see Clark, *Power to Invest Without Yield*, 100 TR. & EST. 495 (1961).

225. *See, e.g.*, Berger v. Burnett, 97 N.J. Eq. 169, 127 A. 160 (1924).

226. *See* York v. Maryland Trust Co., 149 Md. 608, 612, 131 A. 829, 830 (1926). *But cf.* Lambertville Nat'l Bank v. Bumster, 141 N.J. Eq. 396, 57 A.2d 525 (1948) (court overturned settlor's requirement that his speculative stocks and bonds which were declining in value be retained).

227. *See generally* G. BOGERT, *supra* note 4, § 94.

228. *See id.* § 701. *But see* Talbot v. Talbot, 141 Cal. App. 2d 309, 296 P.2d 848 (Dist. Ct. App. 1956), which indicates that the trustee must still meet the guidelines of the prudent man rule. *See also* FLA. STAT. § 518.11 (1979).

229. See notes 29-30 and accompanying text, *supra*.

230. FLA. STAT. § 518.13 (1979), gives a court the power to allow deviation "from the terms of any will, agreement, or other instrument relating to the acquisition, investment, reinvestment, exchange, retention, sale or management of fiduciary property."

231. See note 223 *supra*.

232. *See* Clark, *Power to Invest Without Yield*, 100 TR. & EST. 495, 495 (1961). The suggested clause states: "Anything in my Will or in any code, statute or legal decision of any state or the United States of America to the contrary notwithstanding, my trustee, to the extent it deems such purchase or purchases in the interest of the life tenant and remaindermen, may invest the funds of the trust in low or zero yielding securities or other assets which, in the judgment of my trustee, have adequate growth potential to provide a satisfactory investment accomplishment in terms of future income and/or appreciation in value." *Id.*

233. *Id.* at 496.

234. *See generally* A. SCOTT, *supra* note 1, §§ 187-187.5.

235. For a Florida court's interpretation of this term, see Wallace v. Julier, 147 Fla. 420, 438, 3 So. 2d 711, 718 (1941).

tween principal and income.[236] Therefore, the fiduciary would supposedly have complete control over how much the life cestui should receive yearly, leaving income-deficient property outside the scope of the fiduciary's concern.[237]

Notwithstanding the intent of the draftsman, "absolute discretion" does not in fact grant the massive power so purported.[238] The trustee remains under a duty to treat the successive beneficiaries impartially,[239] and must still make a reasonable determination as to whether a particular item is income or corpus to avoid charges of abuse of discretion.[240] Advantageously, this discretionary provision frees the fiduciary from the controls of the local law, which may be unsatisfactory or vague.[241] The current Florida underproductive trust property statute is one such example,[242] and the settlor may have more faith in the propriety of his trustee's future actions than in the provisions of the law.

The addition of an exculpatory clause may be the least effective way of attempting to block surcharge actions against the trustee for a failure to remedy underproductivity.[243] In this manner, the settlor may try to prohibit lawsuits by providing that the fiduciary would not be liable in connection with such property "except for his willful default or gross negligence."[244] However, one Florida court interpreted a similar trust clause as establishing only a presumptive validity of the trustee's actions, and not absolving his obligation to act in good faith.[245]

One jurisdiction now considers granting such a broad sanctuary for the fiduciary as contrary to public policy.[246] A Florida settlor therefore probably would be unable to protect his trustee in this manner for any acts beyond ordinary negligence.[247]

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236. *See* Hauser, *Tax Problems in Principal and Income Provisions of Trusts*, in THE THIRD ANNUAL INSTITUTE ON ESTATE PLANNING, UNIVERSITY OF MIAMI LAW CENTER ¶69-601 (P. Heckerling ed. 1969). "Absolute discretion" is defined by this commentator as really meaning: "(1) in apportioning items between principal and income, the trustees are not restricted by the law of the particular forum; and (2) a reasonable determination of the trustees as to whether a particular item is principal or income will probably not be considered an abuse of discretion." *Id.*

237. *But see, e.g.*, McDonald v. McDonald, 92 Ala. 537, 542, 9 So. 195, 197 (1891).

238. Hauser, *supra* note 236, ¶69-601.

239. See Wallace v. Julier, 147 Fla. 420, 437, 3 So. 2d 711, 717 (1941).

240. Hauser, *supra* note 236, ¶69-601.

241. *Id.*

242. See notes 180-194 and accompanying text, *supra*.

243. *See generally* G. BOGERT, *supra* note 4, § 542; A. SCOTT, *supra* note 1, §§ 222-222.4.

244. For an example, see *In re* Jarvis' Estate, 110 Misc. 5, 180 N.Y.S. 324 (1920), where the Surrogate held that the trustee's failure to sell declining value securities within a reasonable time period constituted "gross neglect" for the purposes of the exculpatory clause.

245. *In re* Will of Wickman, 289 So. 2d 788 (Fla. 2d D.C.A. 1974). Chief Judge Mann held in this case that a trust clause stating that "[t]he values which my trustees or executors may place upon any property so allotted, provided, and distributed shall be final and conclusive upon all persons having any interest therein" did not block the trust beneficiaries from seeking various remedies based on the trustee's alleged gross undervaluation of certain trust properties. *Id.* at 790-91.

246. New York has abolished "gross negligence only" exculpatory clauses through legislative action. *See* N.Y. EST., POWERS & TRUSTS LAW § 11-1.7 (Consol. 1976).

247. *See* A. SCOTT, *supra* note 1, § 222.3.

Protecting the Income Beneficiary

The creation of special trust provisions to require that the life cestui be provided with a reasonable amount of income has been the subject of extensive debate.[248] A variety of concepts have been suggested to cure insufficient current cash output.[249] The most practical solutions to this dilemma are the reallocation of principal and income charges and earnings,[250] the percentage of income payout method,[251] the annuity trust,[252] and the so-called unitrust.[253]

If the settlor fears that certain assets which will become part of the trust property may become underproductive, he may help mitigate the situation by redirecting various trust receipts and expenses to and from their normal courses. For example, as a potential remedy for low-yielding stocks, the draftsman might stipulate that those corporate distributions which in Florida are otherwise allocable to principal[254] be considered part of the life tenant's income share.[255] The value of the corpus stock would remain unaffected while the income beneficiary gains a representative share of the proceeds, in effect permitting the fiduciary to retain a valuable corporate asset.[256]

A similar opportunity exists for the settlor where depreciable real property[257] is the potential income-deficient asset. If a trust reserve expense for depreciation is established, the income beneficiary faces a double dilemma. Depreciation is customarily charged to income under the reserve account system,[258] and the life tenant loses the benefit of the accompanying income tax deduction.[259] Subsequent underproductivity of the property further exacerbates the income beneficiary's predicament by not reimbursing him for this expense.[260] However, the depreciation allocation problem may be solved through remedies of varying degrees. The settlor's refusal to create a reserve account

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248. *See, e.g.*, Wells, *Pity the Poor Income Beneficiary*, 50 TR. BULL. 30 (1970).

249. *See generally* Note, *Common Stocks in Trust*, 113 U. PA. L. REV. 228 (1964).

250. The many different systems which have been employed to allocate corporate distributions are discussed in Flickinger, *A Trustee's Nightmare: Allocation of Stock Dividends Between Income & Principal*, in 3 LANDMARK PAPERS ON ESTATE PLANNING, WILLS, ESTATES AND TRUSTS 1093, 1096 (Winard comp. 1968).

251. *See* Barclay, *supra* note 216, at 277.

252. *See* STEPHENSON, DRAFTING WILLS AND TRUSTS AGREEMENTS: ADMINISTRATIVE PROVISIONS § 3.7(1)(e) (1952).

253. *See* David, *Principal and Income: Obsolete Concepts*, 43 PA. B.J.Q. 247 (1972).

254. Corpus-allocated receipts include stock dividends, stock split receipts, and liquidation proceeds. FLA. STAT. § 738.06(1)-(3) (1979). Cash dividends, monetary rights involving companies other than the distributing corporation, and constructive dividends from Subchapter S corporations are deemed income. FLA. STAT. § 738.06(3)-(5) (1979).

255. *See* Note, *supra* note 249, at 238.

256. For a model trust instrument provision which would put such reasoning into practice, *see* note 232 *supra*.

257. *See* I.R.C. § 167(a). This note assumes there are no I.R.C. § 1250 recapture problems caused by accelerated depreciation methods for the trust property discussed herein.

258. *See* FLA. STAT. § 738.13(1)(b) (1979).

259. *See* I.R.C. § 167(h) (1979); TREAS. REG. § 1.167(h)-1(b), T.D. 6712 (1979).

260. The depreciation expense, if large enough, may virtually reduce the amount of the trust's distributable net income to little or nothing if a reserve is created and charged to the income account. *See* TREAS. REG. § 1.652(c)-4, T.D. 6712 (1979).

would enable the tax deduction to pass directly to the life tenant.[261] If the income beneficiary is to be favored even further, the settlor could request that depreciation be levied on corpus instead of income, creating an additional cash flow of income in the amount of the expense.[262] Because the reallocation of depreciation could result in erosion of the principal,[263] the settlor must determine the likelihood of the asset's underproductivity and which beneficiaries are most important to him before incorporating this type of provision into the trust instrument.[264]

Several legal scholars have argued that the settlor should include a trust clause mandating distribution of a certain percentage of the market value of the overall trust property to the income beneficiary.[265] The current Florida underproductive property statute[266] initially appears to put this theory into effect. However, in reality the law falls far short of effectuating the theory by failing to provide a sufficient level of income. As opposed to the statutory three percent payment of income,[267] the proponents of this theory suggest the adoption of the projected rate of inflation, expected bond yield, passbook savings interest, or another relative standard.[268] Each of these alternatives would result in a significantly higher rate of return than that created by the inadequate Florida provision.

The proposed "unitrust"[269] also applies the percentage-based income method of countering underproductive assets by combining the trust's original principal and income-connected receipts into a single fund. Under this system, a fixed percentage rate of annual income payout would be calculated by adding the projected income to the probable amount of corpus appreciation, and then deducting a reasonable reserve amount for losses due to inflation and other causes.[270] The Florida trust draftsman should not incorporate the unitrust concept if the settlor wishes to use a conventional marital deduction trust,[271] however, because all of the unitrust's income is not necessarily distributable.[272]

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261. *See* FLA. STAT. § 738.13(1)(b) & (3)(b) (1979).

262. TREAS. REG. §§ 1.167(m)-1(b), 1.652(c)-4, T.D. 6712 (1979).

263. *See generally* FERGUSON, FREELAND & STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES, 310-19 (1970).

264. *See generally* Note, DEPRECIATION AS A TRUST EXPENSE, 4 U. FLA. L. REV. 41 (1951), which provides an early but still valuable discussion of this area.

265. *See, e.g.*, STEPHENSON, *supra* note 252, at § 3.7(2) (1952); Barclay, *supra* note 216, at 277; Wells, *supra* note 132, at 120. For the special problems involved when the life tenant is a charity, see Hauser, *supra* note 236, ¶ 69-611.

266. FLA. STAT. § 738.12 (1979).

267. *See* FLA. STAT. § 738.12(1)(a) (1979).

268. See note 265 *supra*.

269. This concept was originally proposed in Lovell, *The Unitrust*, 105 TR. & EST. 215 (1966), as a method of reducing the amount of conflict between the successive trust beneficiaries by eliminating the problem of whether to allocate receipts and expenses to principal or income.

270. *See* David, *supra* note 253, at 250.

271. *Id.* at 251. For an examination of the use of these very common estate planning devices, see Cornfeld, *Marital Deduction Trust*, in USE OF TRUSTS IN ESTATE PLANNING 383 (1979).

272. David, *supra* note 253, at 251. *See generally* G. BOGERT, *supra* note 4, § 811.

A similar solution to the life tenant's concern is the creation of an annuity trust, which effectively overrides underproductivity difficulties through the payment of a specified annual dollar amount.[273] To guard against inflation, the draftsman can stipulate that the trustee shall either purchase and set aside high-yielding corporate stocks or bond issues as a definite income source,[274] or that the set payments are to be supplemented with a cost of living adjustment based on the Consumer Price Index or similar extrinsic evidence.[275] As with the percentage payment method, the annuity trust is subject to the disadvantage of forcing the settlor to state now what he feels should be a proper future return to the income beneficiary.[276] However, in spite of this minor deficiency, these systems of counteracting later income production shortcomings are valuable estate planning tools as long as the fiduciary retains the ability to make adjustments in the annual payments as necessary.

CONCLUSION

The current Florida underproductive property statute establishes an unprecedented rule of administrative convenience for the corporate and private trustee through a total trust estate concept.[277] However, this advantage is more than outweighed by the law's inequitable treatment of income beneficiaries. The threat posed to the life tenant's interests is made apparent by the fact that a simple passbook savings account would create a greater rate of return than that now authorized by the statute.[278] Moreover, the current inflation rate of approximately one percent per month vastly outstrips the law's limited benefits.[279]

Because of these inherent problems with the statute, the settlor of a testamentary trust to be administered in Florida should be certain to include in his trust instrument those provisions he believes necessary to maintain a steady, reasonable flow of funds to the life cestui while ensuring a protected corpus. In addition, the trustee must be either provided with the necessary powers and resources to dispose of underproductive assets or be shielded from surcharge liability for failing to do so. The uncertain status of the law applicable to Florida fiduciaries will otherwise force the trustee to act overcautiously in such dealings, and thereby penalize all of the trust beneficiaries in terms of lessened cash receipts and a dwindling corpus.

Certain modifications to the underproductive property statute should be made to help correct this dilemma. As recommended by the alternative statute

273. *See* Barclay, *supra* note 216, at 280.

274. Such a fixed-payment trust can be created through a trust instrument clause stating that "If . . . shall survive me, I direct my executor to select and set apart from my estate high-grade securities sufficient in his judgment to produce an annual income of not less than . . . Dollars ($ . . .), and the securities so selected I bequeath to . . . in trust to pay . . . the sum of . . . Dollars ($ . . .) annually out of the income, with power to make up any deficiency out of the principal." STEPHENSON, *supra* note 252, § 3.7(1)(e).

275. Barclay, *supra* note 216, at 280.

276. *Id.* at 277.

277. See notes 181-191 and accompanying text, *supra*.

278. *See* N.Y. Times, November 1, 1979, § A, at 11, col. 2.

279. *See* Gainesville Sun, November 2, 1979, § 2, at 1, col. 1.

appended to this note,[280] the "individual asset" definition of income-deficient property[281] should be reinstated as the best means of protecting the interests of the successive beneficiaries. In addition, the yearly substituted income amount[282] must be raised to a more realistic figure such as six percent per annum in order to provide for a reasonable return to the life tenant. Furthermore, the carrying charge reimbursement provision should be resurrected in order to repay the income beneficiary for such expenses.[283] Finally, the 1975 statute's limited application to "property being held for appreciation"[284] should be restored as necessarily bringing under the law only those assets which the settlor expected to produce yearly funds.[285]

The Florida legislature must act to meet the requirements of the life cestui of a testamentary trust, for many of them depend on this income for basic support.[286] By replacing the apportionment remedy with annual percentage-based payments, the lawmakers took the first step. However, the most recent amendments should be eliminated from the underproductive property statute, with a more realistic level of yearly substituted income being required. With these revisions, Florida law would finally effectuate the settlor's intent that the life tenant not starve so the remainderman may ultimately feast.[287]

LESLIE A. SHARE

APPENDIX
Proposed Underproductive Property Statute,
Replacing Current FLA. STAT. §738.12 (1979)

(1) If any individual asset of the trust principal is being held for appreciation, either by direction of the settlor or in the discretion of the trustee, and such property does not in any year yield a net income of at least 6 percent of its inventory value (including as income the value of any beneficial use of the property by the income beneficiary), such asset is underproductive, and at the end of such year the trustee shall pay to the income beneficiary from the principal, using the first principal cash available, an amount equal to the sum of the following:

(a) Any carrying charges upon such property paid out of income during such year, and

(b) Six percent of the inventory value of such property, or, in default thereof, of its market value at the time the principal was established or its cost when purchased later, less any income received and the value of any beneficial use of the property by the income beneficiary during the year.

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280. This proposed statute attempts to put into force many of the proposed amendments to FLA. STAT. § 738.12 (1979), along with requiring accepted standards of prudence. See notes 192-194 and accompanying text, *supra*.

281. See FLA. STAT. § 738.12(1) (1979).

282. See note 172 *supra*. Note that this amount must also be paid on a pro-rated basis if the income interest does not last for a full twelve-month period. FLA. STAT. § 738.12(1)(b) (1979). Because this provision correctly allows the life tenant to receive his partial interest, it is retained as part of the proposed underproductive property statute found in the appendix.

283. See notes 157-179 and accompanying text, *supra*.

284. FLA. STAT. § 738.12(1) (1975).

285. In order to make this determination properly, the trust instrument must be examined along with the related extrinsic circumstances that the grantor so intended. York v. Maryland Trust Co., 149 Md. 608, 131 A. 829 (1926). See notes 66-71 and accompanying text, *supra*.

286. *See, e.g., In re* Rowland's Estate, 273 N.Y. 100, 6 N.E.2d 393 (1937).

287. *In re* Nirdlinger's Estate, 327 Pa. 171, 174, 193 A. 30, 32 (1937).