

2-1912

## Accounting between Life Tenants and Remaindermen

Frederick Vierling

Follow this and additional works at: <https://egrove.olemiss.edu/jofa>



Part of the [Accounting Commons](#)

---

### Recommended Citation

Vierling, Frederick (1912) "Accounting between Life Tenants and Remaindermen," *Journal of Accountancy*. Vol. 13: Iss. 2, Article 1.

Available at: <https://egrove.olemiss.edu/jofa/vol13/iss2/1>

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Journal of Accountancy by an authorized editor of eGrove. For more information, please contact [egrove@olemiss.edu](mailto:egrove@olemiss.edu).

# The Journal of Accountancy

Official Organ of the American  
Association of Public Accountants

---

Vol. 13

FEBRUARY, 1912

No. 2

---

## Accounting between Life Tenants and Remaindermen

By FREDERICK VIERLING, LL.B.

*Trust Officer of Mississippi Valley Trust Company, St. Louis*

(Continued)

25. Ordinary costs and expenses in the administration of his trust by a trustee for a life tenant and remainderman should be borne by the life tenant and the trustee should pay the same out of the income of the trust estate. The costs and expenses referred to are the mere ordinary administration costs and expenses that are incident to the routine management of the trusteeship, the expenditure of which does not add to the value of property or assets of the trust estate. For example: Rent of safety deposit box for safe keeping of trust estate securities and papers; express charges on securities necessary to be forwarded for delivery if sold or for collection if due; transfer tax, in the event of sale of securities liable to such tax; cost of forwarding and collecting interest coupons and interest notes; postage and stationery for use in business matters of the trust; services of attorneys in connection with business matters affecting the trust estate and not involving the existence of the trust or the title to the trust assets; usual commissions of agent employed to collect rents from realty of the trust estate; services of accountants, bookkeepers and clerks necessary for proper attention to the trust business; services of artisans and laborers in looking after and caring for and repairing trust property; court costs in connection with hearing and auditing annual or interim accounts of the trustee filed in court, planting, caring for, harvesting, selling and shipping crops, where land is cultivated by the trustee; caring for and feeding cattle, etc., and cost of selling and shipping the

increase of live stock, cattle and sheep of the trust estate; also commissions of the trustee from time to time at the legal rate on disbursements of income of the trust estate, but not on principal thereof—the commissions of the trustees on disbursements of principal to be out of the principal of the trust estate. Matter of payment of taxes and insurance premiums is mentioned elsewhere herein.

26. It is not required of a trustee for a life tenant, nor of other trustees, that in his accounts he adjust on his books any increase or decrease in market value of the real or personal property of the trust estate, as from time to time the market value of such property rises or falls. Unless appraised, real estate devised to a trustee is not carried in the accounts of the trustees, being merely inventoried. Personalty bequeathed to a trustee, except in the particular jurisdictions where appraisement is required, should be carried in the accounts of the trustee at par value, whether the market value of the different items is above or below par; corporate shares not full paid should be taken at their paid-up value; securities of no market value, or of merely nominal value, should be scheduled in fiduciary accounts but not extended into the accounts as of any value or at merely nominal value. The same may be said as to realty and personalty conveyed and transferred to a trustee under a trust agreement. Subsequent changes in market value of the respective assets are unnoticed in the accounts of the trustee, so far as affecting the figures of the account. It is well for the trustee in his accounts rendered from time to time to note for information as to each item of assets the then market value thereof. Entries as to assets placed in trust should appear in the principal of the trust account. If under some restriction as to payment over of the net income of the trust estate there should be an accumulation of net income required to be invested, the trustee may carry the investments as invested income, unless required to credit the accumulated income to principal. Purchases of assets in the investment of trust funds should be carried in the trust accounts at actual cost, whether above or below par, subject to amortization as elsewhere herein explained.

Where expenditures for additions and permanent improvements upon realty are made, that are chargeable to principal of the trust estate, if the realty is not carried in the accounts of the

### *Accounting between Life Tenants and Remaindermen*

trustee, such expenditures should be charged off from the principal of the trust estate; but where the realty is carried at appraised value in the trust accounts, such expenditures should be added to the previous amount at which the particular realty was carried and thereafter the realty should be carried at the increased amount.

Where assessments are properly made upon corporate shares held by a trust estate not full paid, such assessments should be added to the inventoried amount of the shares, and the shares thereafter should be carried at the percentage of their face value to which they have been paid up.

Any increase in value of realty or personalty held by a trustee in trust for a life tenant and remainderman, that occurs by appreciation of the assets, as between such beneficiaries, is legally regarded as a profit accruing for the remainderman and when received by the trustee should be credited to principal of the trust estate. Thereafter, the life tenant will receive income on the increased principal of the trust estate, and to that extent only has he any legal interest in such profit by appreciation. Where a loss by depreciation occurs to realty or personalty held by such trustee, as between life tenant and remainderman such loss is legally regarded as falling on the remainderman, and when sustained should by the trustee be charged to principal of the trust estate. Thereafter the life tenant will receive income on the decreased principal of the trust estate, and to that extent only is he legally affected by such loss by depreciation. Any increase in value of assets by appreciation, or any decrease thereof by depreciation, will not appear in the accounts of the trustee usually until sale of the particular asset or assets affected. Upon sale, the market value of the assets sold should be realized by the trustee and the proceeds entered in the principal of the trust estate. Thereupon the accounts of the trustee should show the item of profit by appreciation or the item of loss by depreciation, and the amount should be entered in the principal of the trust estate. In this connection, the attention of the reader is asked to what is below stated as to adjustment between life tenant and remainderman of appreciation of corporate shares held by the trustee, where net earnings of the corporation are not in whole or part applied in payment of dividends by the corporation.

27. In case of foreclosure of a mortgage or deed of trust se-

curing loan held by a trustee for a life tenant and remainderman, question arises as to application of proceeds of sale remaining after payment of costs of foreclosure. If the property is good security, it will probably sell for such sum as will be sufficient to pay the costs of foreclosure and the debt and interest in full, and perhaps leave a surplus. Any surplus, of course, goes to the owner of the property foreclosed, and as to such surplus the trustee of the trust holding the loan has no concern. If the net proceeds of foreclosure are sufficient, the trustee must see to it that out of the proceeds he is paid his debt and interest in full. The interest so received on the mortgage debt goes to the life tenant, and the trustee should credit such interest to income of the trust estate. The payment of the principal of the mortgage debt so received is legally the same as any other repayment to the trustee of money loaned and should be credited to principal of the trust estate and held until reinvested or otherwise properly applied as corpus of the trust estate. If the net proceeds of sale are not sufficient to pay the accrued and unpaid interest and principal of the mortgage debt, an adjustment must be made by the trustee as between life tenant and remainderman, when the trustee receives the net proceeds of foreclosure sale, according to the following basis for such adjustment. The total as to which such adjustment is to be made is determined by ascertaining the amount of interest accrued and unpaid on the mortgage debt and ascertaining the amount of principal remaining unpaid on said debt. The sum of these two amounts is the sum with respect to which the net proceeds of foreclosure is applicable. The trustee thereupon applies such net proceeds of the foreclosure sale proportionately to the two amounts of interest and principal so due on the mortgage debt. The part of such proceeds so applicable to the amount of accrued and unpaid interest legally belongs to the life tenant as income and by the trustee should be credited to income of the trust estate, and the part of such proceeds so applicable to the amount of principal unpaid legally constitutes corpus of the trust estate and by the trustee should be credited to principal of the estate. The result will be that the life tenant will not receive all interest accrued and unpaid on the mortgage debt, but proportionately shares the loss accruing to the trust estate from the investment. This method of adjustment between life tenant and remainderman

### *Accounting between Life Tenants and Remaindermen*

should be followed, notwithstanding the fact that the mortgage or deed of trust may have a stipulation providing for the application of the net proceeds of foreclosure sale first to the payment of delinquent interest on the debt and next toward the payment of the principal of the debt. Such stipulation controls as between the owner of the property foreclosed and the holder of the loan and applies to such holder of the loan so far as relates to the credits to be made on the notes representing the debt and interest, but without considering the equities between the life tenant and remainderman of the trust estate happening to hold the loan. Such credits on the mortgage notes are therefore made independent of such equities and in order to comply with the stipulation of the mortgage. However, such equities must be considered by the trustee when the net proceeds, to which he as holder of the loan is entitled, are received by him under the terms of the mortgage or deed of trust.

In case of the closing out of collateral pledged to secure a loan held by a trustee of a trust estate for a life tenant and remainderman, the method of adjustment by the trustee of the estate as to net proceeds of pledgee's sale of collateral should be the same, as above explained as to adjustment of net proceeds of foreclosure of mortgage or deed of trust securing mortgage loan.

It often happens under the bequest of the residue of an estate that doubtful claims are included, such claims remaining uncollectible for periods more or less extended. Occasionally such claims are realized on; sometimes in full with interest. In the latter case, it is self-evident that the adjustment between life tenant and remainderman should be on the basis that the principal of the trust estate receives credit for the full amount of principal with interest due at death of testator and the income of the trust estate for remainder of the interest. Should the amount collected on such claim not equal the amount of the claim with interest in full, then it becomes necessary for the trustee collecting the amount to make an adjustment between the life tenant and remainderman interested in the trust as to the amount received. The rule as to such an adjustment is that the amount recovered should be apportioned between the life tenant and remainderman, so as to make an allowance to the life tenant as for income on the claim during the time the life

tenant was entitled to interest thereon. The trustee should calculate and ascertain the sum that, placed at legal interest on the date from which the life tenant became entitled to interest on the claim, would to the time of collection of the amount in settlement of the claim equal the amount collected. The amount so ascertained should be held for the remainderman and credited to principal of the trust estate, and the difference between such ascertained amount and the actual amount collected would stand as for interest on such ascertained amount and should go to the life tenant and by the trustee should be credited to income of the trust estate.

28. Where realty is devised to a trustee in trust for a life tenant and remainderman, either or both of whose interests in the realty is subject to an inheritance tax, such tax is required to be paid by the executor, if in addition personalty also passes to the trustee for the same beneficiaries in the same interests; otherwise the amount of such tax must be provided by the trustee or the beneficiaries. Where personalty is bequeathed to such trustee and the interest of either the life tenant or remainderman is subject to inheritance tax, such tax is required to be retained by the executor and paid for account of those interested in the personalty. Where an executor pays and retains taxes assessed only against the life tenant or only against the remainderman, then on payment to the trustee of the money, or on transfer to the trustee of the securities, the trustee receives the legacy less the amount of inheritance tax paid; the trustee in his accounts should credit the full amount of the legacy bequeathed and charge to income the amount of the inheritance tax paid if only against the life tenant, or charge to principal the amount of the inheritance tax paid if only against the remainderman. A situation frequently arising is where both the interests of the life tenant and remainderman are subject to an inheritance tax. In such case the whole fund is taxed and the taxes deducted by the executor from the entire amount, regardless as to the proportion of such taxes properly to be assessed against the life tenant and the proportion to be assessed against the remainderman. The executor does not concern himself as to how the inheritance tax should be borne. If the tax is five per cent., he deducts the amount in gross and pays over to the trustee the balance of the money legacy or transfers the balance of the

### *Accounting between Life Tenants and Remaindermen*

securities passing in trust. When the trustee receives the amount of the legacy less the inheritance taxes deducted, the trustee should credit to principal the full amount of the legacy bequeathed without deduction for any tax; next, the trustee should determine by usual tables the then present value of the life interest of the life tenant in the trust estate, and the balance of the trust estate will represent the then present value of the interest of the remainderman; having determined the present values of the interests of the life tenant and remainderman in the trust estate, the trustee then apportions the tax pro rata, if the tax rates against the life tenant and remainderman are the same, and charges the proper proportion against the income of the trust estate and the balance of the tax against the principal of the trust estate, thus properly adjusting between the life tenant and remainderman the amount of the taxes retained by the executor. If the tax rate against the life tenant and remainderman should not be the same, by reason of their bearing different degrees of relationship to the testator, then the trustee must make a further adjustment, according to any difference in the rate of taxation. After the adjustment the principal of the trust estate, upon which the life tenant will be entitled to the income, will be the amount bequeathed in trust, less the amount of taxes paid for account of the remainderman, and on termination of the trust, by the termination of the interest of the life tenant, there will remain for the remainderman the amount bequeathed in trust less the amount of inheritance tax properly paid for him by the executor and subsequently adjusted by the trustee. Under the above adjustment, at the opening of the trusteeship there will stand charged to the income of the life tenant the amount of inheritance tax advanced for him, which he must refund or which may be allowed to stand until the income on the trust estate shall make up the amount advanced for the life tenant, by reason of the deduction by the executor from the entire fund of the full amount of the taxes.

29. The trustee of a trust for a life tenant and remainderman, if the estate is in funds, is required from year to year to pay out of the estate the annual general taxes assessed against the real and personal property of the estate, as well as annual special taxes for sprinkling or other purposes not considered as for improvements, all payments of taxes to be made before the taxes



respectively become delinquent. Such annual taxes are legally a charge against the life tenant of the trust estate, and should be paid out of the income of the estate. In the event the estate produces no net income, if the estate is in funds, the trustee is, nevertheless, required from time to time to pay such taxes promptly, and in the latter event the payment must necessarily be made temporarily as out of the principal of the estate. Such payment is necessary for the protection of the trust estate as a whole, so as to prevent sale of the trust estate for failure to pay taxes. Subsequently, if the estate produces a net income, the amount advanced out of principal should be restored to principal out of the subsequent income of the estate.

The life tenant of an estate is required from time to time to pay taxes on the estate, after the taxes become payable and before they respectively become delinquent. Until such taxes respectively become payable, it cannot legally be the duty of the life tenant to pay them; such payments can be required only from time to time after the taxes are due and payable.

Where the trustee is authorized and shall purchase property for the estate, the trustee must see that there are no delinquent taxes, or must retain amount necessary out of the purchase price for the payment of delinquent taxes, and, upon consummation of the purchase, must pay such taxes out of the principal of the estate and not out of the income. The trustee is conclusively deemed to have been able to purchase the property at a less price, because of the unpaid taxes, than would have been the case had there been no such taxes.

Where property is devised to a trustee in trust for a life tenant, any taxes a lien on the property at the date of death of the devisor should be paid by the executor under the will, if the estate has personalty out of which to pay the same, and the trustee of the estate must see that such payment is made. Such payment by the executor will for such year relieve the life tenant from the payment of the taxes, although at the time of death such taxes were not delinquent. The general rule is, that the person enjoying the current income of a trust estate must pay the current taxes. It will be noted that in case of the devise of property there is an exception to the general rule, but only as to taxes due at date of death of devisor.

30. On death of the life tenant of an estate during any current

### *Accounting between Life Tenants and Remaindermen*

tax year, question arises as to adjustment of annual taxes for the then tax year as between the legal representative of the life tenant on the one part and the remainderman on the other. In such case the rule is that the annual taxes should be apportioned between the legal representative of the life tenant and remainderman, whether the tax be payable before or after the death of the life tenant. If the life tenant before his death shall have enjoyed eight twelfths of the income from the property during the then current tax year, in adjustment as to taxes of such year the legal representative of the life tenant should be made to assume eight twelfths of the amount of such current taxes, exclusive of penalties for default in payment when due and whether the taxes be paid or unpaid. If a life tenant in possession of property and having funds allows taxes to become delinquent, then the legal representative of the deceased life tenant must assume penalties accrued because of the default. If the trustee in charge of the estate is negligent in payment of such taxes, the penalty should be assumed by the trustee personally. Where neither the life tenant nor trustee is negligent, then in fairness the penalties on the tax should be assumed by the legal representative of the life tenant and the remainderman in proportion as they assume the taxes without penalties. The state or municipality levying the tax does not concern itself with any of the adjustments of the taxes referred to. So far as the state or municipality is concerned, a tax upon land until paid follows the land into the hands of the successive legal owners. A further question arises in states where by the laws of the state taxes become a lien prior to the year for which the taxes are assessed; for example, in Missouri the taxes for the year 1911 became a lien on June 1, 1910. In such case the query is: Should the life tenant die after the taxes for 1911 became a lien and before they became payable, what proportion, if any, of the taxes for 1911 should be charged against the life tenant? On the principle above stated, that the life tenant is liable only for the taxes accruing during his tenancy, no part of the taxes of the year following his death must be assumed by his estate.

It will be recalled that on the death of an owner of realty all taxes a lien at the time of death, although not payable until after the death of such owner, are to be paid by the executor or administrator of the deceased owner. If the estate of such deceased

owner were devised or bequeathed in trust for a life tenant and remainderman, the life tenant would enjoy the income of the first year from the estate without being required to pay the taxes of such year, and later would enjoy a proportionate share of the income of the last year of his life tenancy, with responsibility for only a proportionate share of the taxes of such last year, although a lien but not payable before the termination of the life tenancy. Thus it appears that two opposite rules prevail in case of death of an owner and in case of death of a life tenant.

31. The trustee of a trust for a life tenant and remainderman, if the estate is in funds, is required from time to time to pay out of the estate all special taxes for public improvements in the district where the property is located and assessed against the property, such as the making of streets and alleys or doing other public work, all payments to be made before the taxes respectively become delinquent. While such improvement taxes are for work in the nature of an improvement to the property and should add to the value of the property, yet such taxes must legally be borne by the life tenant and paid by the trustee out of the income of the estate, unless there is provision in the instrument or will creating the trust to the contrary, or unless the question is adjudicated in proper court proceedings and the court should direct payment entirely out of principal or partly out of income and partly out of principal. It is generally considered that the original making of a street or alley or other public work usually adds to the value of the property taxed therefor; but that is not always necessarily so. It certainly is not true where a special tax is assessed for reconstruction of a street or for public work that had theretofore been made or done. The trustee may have a strong opinion in a given matter, but he is not a court and cannot finally settle the question, unless under the instrument or will or by proper order of court he is given discretion so to do. Therefore, where there is not an express exception as noted, the general rule prevails that improvement taxes assessed against property of a trust estate must by the trustee be paid out of the income of the estate. Where such work is done by private contract of the trustee, the same principles govern.

32. It is a general rule that a general money legacy does not bear interest until from one year from date of death of the testator, unless expressly otherwise provided in the will; that if such

### *Accounting between Life Tenants and Remaindermen*

general legacy be not paid at the end of one year from date of death of the testator, then until paid the legacy bears interest at the legal rate, to be paid out of the estate of the decedent. The same is true of a money legacy to a trustee in trust for a life tenant and remainderman, and the result is that for the first year from date of death of the testator the life tenant is not entitled to any income on the cash sum bequeathed in trust. At the end of such first year the sum bequeathed becomes payable and on receipt by the trustee the amount bequeathed should be held for the remainderman and credited to principal of the estate and promptly invested, the income earned thereon thereafter to go to the life tenant. In the event the legacy is not paid by the executor at the end of one year from date of death of the testator, then and thereafter on payment of the legacy the trustee is entitled to receive the amount bequeathed and interest thereon at the legal rate from one year from the date of death. The interest so received from the executor by the trustee should go to the life tenant of the estate and by the trustee should be credited to income of the trust estate, although the interest was earned on the fund prior to the time of payment of the legacy to the trustee.

Any money placed in trust under a trust agreement is necessarily received by the trustee without right to interest and no adjustment as to interest is required, since the life tenant is legally entitled only to the net income earned on the fund from the investments by the trustee during the life tenancy.

33. Should chattels be included in a bequest to a trustee for a life tenant and remainderman, the custody and use of which chattels is not expressly given to the life tenant, and since the trustee is not without express direction authorized to give the possession and use of such chattels to the life tenant, in order that the life tenant shall receive any benefit from his life interest in such chattels the law requires that the trustee sell such chattels without sacrifice and within a reasonable time and for their reasonable value, so that their proceeds may be invested and earn income for the life tenant. The question as to what is a reasonable time is a question of fact and must be determined in each particular case. What may be considered a reasonable time in one case may not be so considered in another. A trustee will be allowed more time to dispose of costly diamonds and jewelry

than would be allowed as to articles depreciating by the mere holding or expensive to hold. As to chattels not depreciating by the mere keeping, a year has been held not to be an unreasonable time for their disposition. If the articles are of a perishable nature, so that in the mere keeping they would depreciate in value, or if the articles are of such a nature that they will become less desirable by keeping, as a stock of merchandise that will become stale or wearing apparel that will go out of style, both consequently growing less salable, it is required of the trustee that reasonably prompt disposition be made of such articles at a fair price and before they become affected by the particular conditions that may impair their sale.

34. Should an estate received by a trustee for a life tenant and remainderman consist entirely or in part of horses, cattle, sheep or other live stock, unless there is an express direction to the contrary, or unless the contrary intention is necessarily implied, the trustee should as promptly as may be without sacrifice sell such property for its reasonable market value and promptly invest the proceeds as may be authorized by the instrument or will creating the trust or as required by law. The life tenant is entitled to the income on such proceeds, and such income should be credited to income of the trust estate. While a trustee may receive live stock in trust, such property is not a legal investment for trust funds and the trustee should dispose of such property as soon as may be reasonable, considering conditions surrounding the estate. A will bequeathing such property, as in case of other property, takes effect as of date of the death of the testator, and, subject to rights of creditors of the testator and payment of costs of administration on the estate of the testator, the life tenant is entitled from such date of death to the profits of such property bequeathed and to the income on the proceeds thereof after sale. Any increase from the live stock should go to the life tenant and the trustee should credit such increase or the proceeds thereof to income of the trust estate. In case of sheep, the net profits from the sale of wool should go to the life tenant, and the trustee should credit the net proceeds to income of the trust estate; also any compensation received for services of animals valuable for breeding purposes. The trustee should feed and care for the live stock held in trust and the expense thereof should be borne by the life tenant and paid out

### *Accounting between Life Tenants and Remaindermen*

of income of the trust estate. The expense of marketing the increase of the live stock, and the expense of marketing any product of such live stock, are expenses that should be borne by the life tenant and the trustee should charge such expenses to the income of the trust estate. It is the duty of the trustee to make a full and complete inventory of the number, kind, age and quality and appraised value of such live stock at the time of the taking effect of the trust as to such property, so as to establish the extent, quality and value of the herd at the beginning of the trust estate and fix the basis to which the herd must be substantially maintained to protect the remainderman and the basis on which the net profits are to be calculated. It is not to be understood that the identical number of the herd as to age and other points must be exactly maintained, as that will not be practicable, but the commercial standard of the herd must be substantially maintained. For instance, it would not do to keep a herd of cattle originally inventoried and not sell any of them, but only the calves in the herd from time to time, as in a few years the original herd inventoried would largely deteriorate by reason of age; rather should the trustee sell off the original cattle inventoried from time to time and as proper business management would demand, an equal number of head of new cattle being retained from the grown calves of the herd or purchased to infuse new blood into the herd, thus in a businesslike manner maintaining the quality of the herd as well as the number therein. While the appraised value of the herd should be determined at the taking effect of the trust, the value in dollars so determined is not conclusive upon the remainderman as fixing the amount of the principal of the estate in which he is interested. If the number and standard of the herd be maintained, yet the market value may by appreciation increase, as other property, to the benefit of the remainderman; or, as other property, may decrease by depreciation, to his detriment. Either would be determined in the event of subsequent sale of the entire herd, instead of merely the increase and products thereof. True, if the herd were sold at the time of the first inventory and if the proceeds realized the appraised value in dollars, the amount of the principal of the trust estate to be held for the remainderman would be fixed at such proceeds; yet, until there is a sale of the entire herd, the exact value to the remainderman is not determined. Should part

or parts of the herd be sold from time to time, the same principles apply where such part or parts are not to be taken as belonging to the natural increase of the herd under the principles above mentioned. A herd of cattle belonging to a trust estate is merely a stock in trade, the same as merchandise in a mercantile business which may be placed in trust for a life tenant and remainderman. The law does not favor the investment of trust funds in trade or business, and this includes the conduct of a business connected with the handling of live stock.

The foregoing remarks apply to live stock considered from a business view. Such remarks do not apply to pet animals or other animals specifically mentioned in the instrument or will creating the trust for a life tenant and remainderman, such as a valuable trotter or prize cow and other particular animals having a personal, special or peculiar value. As to such animals, if express direction or authority is given to allow the life tenant the use of the animals, the life tenant may use them in a usual and reasonable manner, feeding and taking usual care of them. In the event of the death of such animals during the trust without the negligence of the life tenant, the loss falls on the remainderman. If no express authority is given the trustee to allow the life tenant to use the animals, then the trustee can only dispose of them and invest the proceeds, the income on such investment with other income to go to the life tenant and by the trustee to be credited to the income of the trust estate.

35. Where shares of stock in a business corporation are held by a trustee for a life tenant and remainderman, such trustee, so far as participation in the profits of the corporation is concerned, stands on the same footing as any other stockholder of the corporation, and the trustee is not entitled to any proportion of such profits until declared as dividends at the discretion of the directors of the corporation from time to time. The rule as to shares held by a trustee for a life tenant and remainderman is that dividends declared out of current earnings and paid the trustee for a life tenant and remainderman should go to the life tenant, and on receipt by the trustee should be credited to income of the trust estate. As to dividends out of current earnings, the law is now well settled, whether such dividends be declared payable in cash, in securities in the treasury of the corporation declaring the dividends, or in treasury stock of the corporation declaring the

### *Accounting between Life Tenants and Remaindermen*

dividends, that such dividends out of current earnings should go to the life tenant of a trust for a life tenant and remainderman. Where the dividends are regular, or fairly regular, and the corporation has current earnings, it will be presumed that the dividends declared are out of its current earnings. Extra cash dividends declared by a corporation during the continuance of a trust for a life tenant and remainderman, being merely extra out of current earnings, and not amounting to a distribution of any of the surplus or undivided profits of the company earned before the trust was created, likewise go to the life tenant and when received by the trustee should be credited to income of the trust estate. Where shares are bequeathed to a trustee in trust for a life tenant, and on which a dividend has been declared by the corporation but not paid at the death of the testator, such dividend should be collected by his executor and go into the general estate of the decedent and not to the life tenant. Where dividends declared are not out of current earnings, then the general rule stated does not apply and close discrimination is required in the adjustment of the dividends between income and principal of the trust estate, for the protection, respectively, of the life tenant and remainderman.

Where shares are purchased by a trustee for a life tenant and remainderman and at the time of such purchase a dividend has been declared on the shares but has not been paid, and if the transfer books of the corporation as to the payment of the dividend have not been closed, so that transfer of the shares may be made and the trustee collect the dividend declared before the purchase of the shares, yet, on receipt of such dividend, and even if out of current earnings, such dividend should not go to the life tenant, but should be held for the remainderman and credited to the principal of the trust estate. In such case it is conclusively presumed that the market value of the shares was increased by the amount of the dividend, and that the cost of the shares to the principal of the trust estate was increased by such amount over what would have been the cost had the dividend not been declared, so that on collection of the dividend and credit thereof to the principal of the estate the cost of the shares will be brought down to the proper basis.

36. The value of shares of stock bequeathed in trust under a will, for the purpose of valuation with respect to the principal



of the trust estate, is determined as of the date of death of the testator, such date being the time when such trust becomes effective. The value of shares of stock transferred in trust under a trust agreement, for like purpose of valuation with respect to the principal of the trust estate, is determined from the date of execution and delivery of the instrument, such date being the time when the trust comes into legal existence. In either case in such valuation the capital, surplus and undivided profits of the corporation are taken into consideration. The sum of these items, if the assets of the corporation are carried on its books at fair values, is the amount fixed as the amount in which each share represents a proportionate interest or value, and gives the basis for the valuation of the shares placed in trust. The items mentioned are not conclusive as to the market value of the shares, since shares in a popular corporation doing a large business and paying regular and large dividends will sell on the market for considerably in excess of the actual book value of the shares. However, the sum of said items is the sum with respect to which constant reference must be had in connection with shares held by a trustee in trust for a life tenant and remainderman, to determine the net earnings of the corporation during the life tenancy. Corporations do not from year to year pay out their current net earnings in dividends, so that at the end of each year the book value of its shares will fall back to the amount held at the end of the previous year. This would be fine as to question of earnings on shares held in trust for a life tenant and remainderman, but is too ideal ever to be true. As stated, the trustee holding shares is entitled to receive only such dividends as the directors of the corporation in their discretion deem proper to declare, such declaration always depending on the actual net earnings of the company and the needs of the company in the conduct of its business. In estimating the net earnings of the corporation, the law requires the directors to set aside proper reserves for depreciation by wear and tear of property by use and for depreciation by decline in value and for other purposes, depending on the status of the business and property of each separate corporation. If the reserves are greater than necessary, the excess is an earning that might have been counted but has been postponed, and if the reserves are smaller than amounts required for the respective purposes the current loss does not appear until later, when the

### *Accounting between Life Tenants and Remaindermen*

deficit is carried through the corporate accounts. If property in the hands of a trustee for a life tenant and remainderman appreciates in value, yet the trustee cannot consider the amount of the appreciation as an earning and credit it to the income of the estate; but the directors of a corporation may consider appreciation of its property as an earning and credit the increase in value to the profit account, and with respect thereto declare a dividend or dividends. Any dividends declared and paid by the corporation entirely out of surplus and undivided profits of the corporation on hand at the time the trust for a life tenant and remainderman comes into existence, should not go to the life tenant, but should be held for the remainderman and credited to principal of the trust estate, since the dividend is not out of earnings of the corporation since the taking effect of the trust and is in diminution of the value of the shares as found at the beginning of the trust, and should be treated as a collection on account of such value and be held in the principal of the trust estate, the same as would the partial payment on a principal note held as an investment of the estate. Where the value of stock consists in part of surplus and undivided profits of a corporation at the date when a trust for a life tenant and remainderman takes effect, as between the life tenant and remainderman the surplus and profits should be kept intact. The life tenant is entitled to dividends earned and declared during his life tenancy from the net profits of the conduct of the business of the corporation, and not from profits by mere appreciation of its property. A corporation may pay dividends out of its assets, so long as it does not impair the par value of its shares, and it thus may pay dividends out of current earnings, out of its undivided profits, out of its surplus, and out of earnings by appreciation of its property—as distinguished from earnings from the conduct of its business. A life tenant is entitled to dividends out of current earnings from the business of the company and out of undivided profits or surplus earned during the existence of the trust; the life tenant is not entitled to dividends out of undivided profits or surplus earned before the existence of the trust, and is not entitled to dividends declared out of profits by appreciation of property owned by the corporation at the creation of the trust—as distinguished from earnings by the conduct of the business of the company. A dividend declared out of profits resulting from the sale of real estate

*The Journal of Accountancy*

owned by a business corporation at date of death of a testator is a dividend out of appreciation in value of the property sold, not a dividend out of the conduct of the business of the company, and legally should be held for the remainderman, and when received by the trustee should be credited to principal of the trust estate. As dividends are declared and paid from the sources mentioned they do not show their origin, and the trustee must be cautious in the matter of crediting to income or principal. If unusually large the trustee is put on inquiry, and if the facts cannot readily be determined the trustee should bring proper proceedings in court to investigate the facts, to which proceedings all parties interested in the trust estate should be made parties, so that the court may determine how the particular dividend shall be credited, in whole or in part to income or principal, or both. It is now immaterial whether the dividend be all in cash, or all in securities in the treasury of the company, or all in treasury stock of the company, or partly the one or the other; formerly it was otherwise.

*(To be continued)*