NORTH CAROLINA LAW REVIEW

Volume 15 | Number 1 Article 24

12-1-1936

Trusts -- Principal and Income -- Apportionment of Income from Part of Estate Used to Pay Legacies, Debts and Costs of Administration

James M. Verner

Trusts—Principal and Income—Apportionment of Income from Part of Estate Used to Pay Legacies, Debts and Costs of Administration.

Action by a testamentary trustee to determine how properly to dispose of $11,946.13, income derived during the entire period of administration from that portion of the estate used to pay specific legacies, debts and costs of administration. Under the terms of the trust the income was to be paid to the testator's children and their issue during their lives, remainder over to members of a class. *Held,* the money in question was payable as income to the life tenants and not to corpus for the benefit of remaindermen.[1]

This is a case of first impression in North Carolina. Elsewhere, two rules, the English rule and the Massachusetts rule, have been developed to govern the trustee in meeting the problem.[2] The English rule, with which Connecticut,[3] Maryland,[4] New Hampshire,[5] New Jersey[6] and the Restatement of Trusts[7] are in accord, was originally formulated in the case of *Allhusen v. Whittell,*[8] as follows: "But the executors, when they have dealt with the estate, will be taken by the Court as having applied in payment of debts such a portion of the fund as, together with the income of that portion for one year, was necessary for the payment of the debts. . . . It is clear that the tenant for life ought not to have the income arising from what is wanted for the payment of debts, because that never becomes residue in any way whatever." That is to say,[9] "a life owner of a testator's estate must only receive income from that portion of the capital which forms the net, or more correctly, the actual residue of that estate."

The rule eventually required judicial modification to prevent injustice to the life tenant where payments on account of debts, legacies and expenses were made early in the year[10] and again where they were

[1] Wachovia Bank and Trust Co. v. Jones, 210 N. C. 339, 186 S. E. 335 (1936).

[2] See 4 BOGERT, TRUSTS AND TRUSTEES (1935) §811, n. 3; GODEFROI, TRUSTS AND TRUSTEES (5th ed. 1927) §284. The problem appears not to have been dealt with by the UNIFORM PRINCIPAL AND INCOME ACT, 9 U. L. A. 1935 CUM. ANN. POCKET PART 167.

[3] Bridgeport Trust Co. v. Fowler, 102 Conn. 318, 128 Atl. 719 (1925).

[4] York v. Md. Trust Co., 150 Md. 354, 133 Atl. 128 (1926).

[5] White v. Chaplin, 84 N. H. 208, 148 Atl. 21 (1929).

[6] Willard's Ex'r v. Willard, 21 Atl. 463 (N. J. Ch. 1891); *In re* Rowland's Trustees, 87 N. J. Eq. 307, 101 Atl. 52 (1917).

[7] RESTATEMENT, TRUSTS (1935) §234 (g).

[8] L. R. 4 Eq. 295, at p. 303 (1867). It is difficult, in view of the date of that case, to agree with the view expressed in the dissenting opinion of Chief Justice Stacy in the principal case, that under N. C. CODE ANN. (Michie, 1935) §970, the English rule is a part of that body of English common law which North Carolina adopted from the mother country, and which controls until changed by statute.

[9] STRACHAN, *The Rule in Allhusan v. Whittell* (1914) 30 LAW Q. REV. 481.

[10] *In re McEuen,* 2 Ch. 704 (1913).

made several years later.[11] This change[12] is thus phrased by the Restatement of Trusts:[13] "A proper method of determining the extent to which legacies, debts and expenses of administration should be paid out of the principal is by ascertaining the amount which, with interest thereon at the rate of return received by the executor upon the whole estate from the death of the testator to the dates of payment, would equal the amounts paid. This amount is charged to principal and the balance of the amount paid is charged to income." The resulting accounting problems[14] are so intricate and difficult that eminent English conveyancers have suggested the insertion in the will of a clause leaving the whole matter to the discretion of the trustee.[15]

The Massachusetts rule, adopted by statute[16] in New York in 1931, and followed by North Carolina in the principal case, awards to the life tenant the entire income from the date of the death on that part of the estate used to pay the charges in question. It is based on the theory that the residue is formed at the testator's death, subject to the payment of legacies, debts and expenses, and on a presumption that giving the income to the life tenant more nearly meets what probably would have been the testator's intention had his mind been directed to the question.[17]

The fact that the life beneficiaries in the principal case were children and grandchildren, while the remaindermen were those who would have been heirs had the trustor died intestate at the date of the vesting in the remainderman, made the availability of a rule based on probable intention particularly welcome. Accounting problems were thus avoided and definiteness and simplicity of administration facilitated.

JAMES M. VERNER.

[11] *In re* Wills, 1 Ch. 769 (1915).

[12] STRACHAN, *loc. cit. supra* note 9, ably discusses the net significance of the modification.

[13] RESTATEMENT, TRUSTS (1935) §234(g).

[14] Compare STRACHAN, *supra* note 9, and note (1924) 37 HARV. L. REV. 250.

[15] STRACHAN, *loc. cit. supra,* note 9.

[16] N. Y. PERS. PROP. LAW (1927 as amended 1931) c. 42, §17 b. Before this New York followed what later became the English view. Williamson v. Williamson, 6 Paige Ch. 298 (1837); *In re* Ryan's Estate, 250 N. Y. Supp. 522, 140 Misc. 364 (1931).

[17] Mulcahy v. Johnson, 80 Colo. 499, 252 Pac. 816 (1927); Weld v. Putnam, 70 Maine 209 (1879); Wethered v. Safe Deposit and Trust Co., 79 Md. 153, 28 Atl. 812 (1894); Minot v. Armory, 2 Cush. 377 (Mass. 1848); Lovering v. Minot, 9 Cush. 151 (1851); Treadwell v. Cordis, 5 Gray 341 (Mass. 1855); Loring v. Mass. Horticultural Society, 171 Mass. 401, 50 N. E. 936 (1898); Edwards v. Edwards, 183 Mass. 581, 67 N. E. 658 (1903); McDonough v. Montague, 259 Mass. 612, 157 N. E. 159 (1927); Old Colony Trust Co. v. Smith, 266 Mass. 500, 165 N. E. 657 (1929) (relied on heavily by the North Carolina court in the principal case); *cf.* Old Colony Trust Co. v. Forsyth Dental Infirmary, 271 Mass. 511, 171 N. E. 734 (1930), where the income went to corpus. Is the distinction between the two cases that the will did not manifest the usual intention well taken?; City Bank Farmers' Trust Co. v. Taylor, 53 R. I. 126, 163 Atl. 734 (1933); Will of Leitsch, 185 Wis. 257, 201 N. W. 284 (1924).