Volume 35
Issue 3 *Dickinson Law Review - Volume 35, 1930-1931*

3-1-1931

Distribution of Extraordinary Dividends in Corporate Stock Trusts

W.H. Dunbar III

shown to have been of more or less than one-half? The act is silent on the subject. The only facts that would seem to be relevant to rebut the presumption would be the facts as to the actual, original ownership of the property.[18] If the survivor shows that the property was originally his and that the joint ownership form resulted from his gift, the conclusion would be that no tax is due as there is no transfer. But is there not actually as much a transfer by death in such a case as where the property was paid for equally by both? Is the presumption rebuttable by the Commonwealth? May it show that the survivor originally owned none of the property and that, therefore, the transfer is of all of the property? There is no reason to distinguish the two situations. It is inevitable that the question will give rise to much dispute in the collection of taxes. It is to be regretted that the act did not make the presumption irrebuttable.

Harold S. Irwin

DISTRIBUTION OF EXTRAORDINARY DIVIDENDS IN CORPORATE STOCK TRUSTS

Where a trust consists of corporate stocks an interesting question is presented as to whether the life tenant or the remainderman or both are to benefit by the extraordinary dividends. The majority rule[1] commonly called

[18] The expression used in the federal act is a nicer one. The act imposes the tax on the whole of the property held by the deceased joint tenant or tenant by the entirety but creates an exception, with the burden on the taxpayer to show such exception, "such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth . . ." See 26 U. S. C. A. sec. 1094 (e).

[1] Discussion of Pennsylvania rule up to 1928, see 33 Dickinson Law Review 31; review of Pennsylvania decisions (1927) Nirdlingers Estate 290 Pa. 457. General discussion of all rules—notes (1921) 13 A. L. R. 1004; (1923) 24 A. L. R. 9; (1926) 42 A. L. R. 448; (1927) 50 A. L. R. 375; (1928) 56 A. L. R. 1287, 1315; (1929) 59 A. L. R. 1532.

the "American" or "Pennsylvania" rule is, that in every extraordinary distribution the time when the profits were earned by the corporation determines who the recipient of the extraordinary distribution should be and to what extent, and that apportionment should be made accordingly between income and corpus.[2] This rule, popular because of its evident equitableness, has been discarded in the second tentative draft (1929) of a Uniform Principal and Income Act, and the Massachusetts rule adopted because of its much greater simplicity of application. Section 5, CORPORATE DIVIDENDS AND SHARE RIGHTS. "All dividends accruing on shares of a corporation which form a part of the principal and payable in the shares of such corporation shall be deemed principal—all dividends payable otherwise than in the shares of the corporation itself shall be deemed income. Where the trustee shall have the option of receiving a dividend either in cash or in shares of the declaring corporation, it shall be considered a cash dividend and deemed income, irrespective of the choice made by the trustee."[3] The basis of this rule is the form in which the dividend is declared.[4]

The majority rule has been applied in Pennsylvania to stock dividends,[5] extraordinary cash dividends,[6] rights to subscribe to stock,[7] liquidation by a corporation, or on a sale by the trustee shortly before liquidation which the court held tantamount thereto,[8] and a sale of the shares by the trustee at a price largely in excess of their actual value at the inception of the trust.[9] In a recent case[10] where

---

[2]Earp's Appeal, 28 Pa. 368 (1857).

[3]See National Conference of Commissioners on Uniform State Laws (1929) 112, 285 et seq. Second tentative draft prepared by Dean Charles E. Clark.

[4]Minot v. Paine, 99 Mass. 108 (1868).

[5]Smith's Estate, 140 Pa. 344 (1891).

[6]Stake's Estate (No. 1), 240 Pa. 277 (1913); Stake's Estate (No. 2), 240 Pa. 288 (1913).

[7]Jones v. Integrity Trust Company, 292 Pa. 149 (1928).

[8]McKeown's Estate, 263 Pa. 78 (1919).

[9]Nirdlinger's Estate, 290 Pa. 457 (1927).

[10]Graham's Estate, 296 Pa. 436 (1929).

two banking corporations merged, and where in order to adjust the respective contributions of the merging corporations to the resulting corporation the stockholders of one corporation received more shares in the new enterprise than the stockholders in the other, the court held the rule applied and ordered distribution, on the finding of the auditing judge that the additional shares were an extraordinary dividend, to which finding there was no objection. A later case, on the other hand, holds that on a merger where the parties received the same number of shares of which the book value was largely increased, the addition was not income but merely an increase in the original value of the shares.[11] The court in this case points out that a merger is not a liquidation because all the assets of the corporations involved continue intact in the new corporation, representing a substantial value reflected in the price of the shares. It was not a sale because there was no severance of all the rights in the shareholders. The issuance of new stock was considered new evidence of ownership.

Beginning with *Boyer's Appeal*[12] the supreme court consistently held that the creator's intention to have such distributions treated as income or corpus was conclusive. While this rule was extant it was safe for attorneys to advise a provision in the trust instrument providing specifically for the retention of all extraordinary distributions as part of the corpus of the estate and so avoid an apportionment. Lately the court has qualified the rule by saying that, "What the deed or will specifies must be carried into effect, *so far as it is legal.*"[13] At the time of this qualification it was believed the court had in mind a New York decision which held that the creator could not call that corpus which the decisions of the state determined to be income, because such a direction would violate the statutes prohibiting accumulations of income, and consequently such a provision

[11]Buist's Estate, 297 Pa. 537 (1929).

[12]224 Pa. 144 (1909). See also 24 A. L. R. 9 (Note); Robinson's Trust, 218 Pa. 481 (1907).

[13]Jones v. Integrity Trust Company, 292 Pa. 149 (1928).

invalidated a codicil to a will.[14] This belief is strikingly confirmed by a current decision of our Supreme Court.[15] The testator gave his residuary estate in trust to pay the net income to his widow for life with remainder over, with a provision in the residuary clause that "all stock dividends shall be considered principal". Mr. Chief Justice Moschzisker there declared that despite the testator's direction that all stock dividends should be considered as principal, they remain income because so held by the courts as a rule of law; and since this income is in effect ordered to be unlawfully accumulated under sec. 9 of the Act of 1853, P. L. 503, 507, it became presently distributable.

It has been said that the apportionment theory as laid down by the court is broad enough, where the creator only uses the word "income", to cover every conceivable kind of distribution to which the apportionment theory applies, and that as a result the beneficiary in a spendthrift trust would get large blocks of stock which he could readily convert into cash and dissipate. Although this would logically follow from *Maris's Estate, (supra),* it is unlikely that such an obviously unintended result would be permitted, but rather that an exception would be created and the dividend given to the remainderman, or as in a lower court case[16] hold that the dividend was corpus. The apportionment theory is an equitable rule and should be flexible and adaptable to such equity seeking cases to bring about just results.

Another query has been, how will the income be distributed where there are successive life tenants and the first life tenant dies before the dividend is declared. In a late case,[17] where there were successive life tenants and the first had died before the extraordinary dividend was declared, it was held that there is a presumption that the dividend is payable to the party entitled to the income when the dividend is declared (here the second life tenant), but that this presumption must yield to proof of adverse facts,

---

[14]In Re Megrue, 217 N. Y. 653 (1915).
[15]Maris's Estate, 301 Pa. 20 (1930).
[16]Pitcairn's Estate, 70 Pittsburgh Law Journal 417 (1922).
[17]Graham's Estate, 296 Pa. 436 (1929).

that is, proof of the manner in which the dividend is made up and that its existence will not injure the original investment or intact value. In this case counsel for the first life-tenant's heirs did not prove such adverse facts and the whole dividend was awarded to the second life-tenant. From this decision it would appear that in a proper case the supreme court will distribute such a dividend among successive life tenants accordingly as the dividend was earned during the tenancy. The question has never been decided by the supreme court but has been settled as suggested in an unreported county case.[18]

Such a decision has been reached in New Jersey, a state following the Pennsylvania rule.[19] Vice Chancellor Buchanan there said, "When the gift of income to a life tenant or successive life tenants is in general language, and there is nothing to indicate a different intention, it would seem the fair interpretation to accord to the testator the intention that each life tenant should have as income such profits as were earned by the capital of the trust during the life tenancy; and this seems the fairest disposition from the point of equity. This would lead to the apportionment, between the second life tenant and the estate of the first life tenant, of so much of any dividend declared after the death of the first life tenant as represented earnings; such apportionment to be in accordance with the share of the earnings earned in the respective lives of the two life-tenants."

The courts, in determining the value of the stock at time of testator's death and after the declaration of the stock dividend, in order to make apportionment accordingly, have used many different tests to determine that value. *Earp's Appeal (1857)*[20] was decided on market values, *Moss' Appeal (1877)*[21] used actual or intrinsic values in order to avoid fluctuations of the stock market, and in *Eisner's*

---

[18]Miller's Estate, Orphans Court of Philadelphia County, January Term, 1909, No. 65.

[19]Hagedorn v. Arens, (N. J. 1930) 150 Atl. 4.

[20]28 Pa. 368.

[21]83 Pa. 264.

Estate, (1896)[22] actual value to be determined from the best methods at command was the test adopted. After *Stake's Estate, (1913)*[23] book value was almost always used, but this test was repudiated in *Thompson's Estate, (1918)*[24] where the court said they were interested only in actual value and not concerned with book value. In view of this uncertainty *Baird's Estate (1930)*[25] at least offers temporary relief. It was there held that book value is the test. The court said, "The prima facie standard of measurement of intact value of trust estates, the income of which is to be paid to a beneficiary with remainder over, is the book value; and this standard remains fixed unless it can be established that the elements making up the book value are not true values". It is interesting to note the court's reasons for adopting this as a test as they show the courts are trying where possible to simplify the rule. It is pointed out that capitalization of income over long periods and the averaging of values cannot be considered because too uncertain for definite purposes; and actual appraisment, though sometimes necessary where book value is not available, is often impossible because of prohibitive costs.

W. H. Dunbar, III

THE ATTRACTIVE NUISANCE DOCTRINE IN PENNSYLVANIA

Running through almost every phase of its law, is an extraordinary protection given to infants in Pennsylvania. Sometimes, apparently, this protection was unwarranted. However, until recently it was never questioned that infant trespassers were in no better position than adults.

Within the past few years our courts, probably inadvertently, have allowed statements to creep into their

---

[22]175 Pa. 143.
[23]240 Pa. 277 and (No. 2) 240 Pa. 288.
[24]262 Pa. 278.
[25]299 Pa. 39.