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Decedents' Estates And Trusts—Allocation of Extraordinary Stock Dividends to Trusts Established Prior to 1926

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but could not be found among the testatrix's effects at her death. The ring was insured and the proceeds of the insurance, $4000, were paid into the estate. Both the specific legatee of the ring and the residuary legatee claimed the proceeds.

The Court of Appeals affirmed the Appellate Division,[19] holding for the residuary legatee because the specific legatee was unable to carry the burden of proof that the ring disappeared after the death of the testatrix. Had the plaintiff proved this fact, she would have prevailed, as the ring would have passed by the will and the property being hers, she would have been entitled to the insurance proceeds.

In holding for the specific legatee the Surrogate was of the opinion that since testatrix's title to the ring would be superior to that of a finder or thief, if the ring disappeared before death, the specific legatee inherited this superior title and consequently was the only one who could sign a release of all right, title, and interest in the ring to the insurance company in return for the insurance proceeds.[20] Thus, it did not matter whether the ring disappeared before or after the death of testatrix.

The fallacy of this position, however, is that if the ring was lost prior to the death of the testatrix, the title to the ring cannot pass by the will because the insurance proceeds are substituted for it, and it is settled that the specific legatee is not entitled to insurance proceeds for a gift which is adeemed by change or disappearance before the death of the testator.[21]

ALLOCATION OF EXTRAORDINARY STOCK DIVIDENDS TO TRUSTS ESTABLISHED PRIOR TO 1926

At present in New York, Section 17(a) of the Personal Property Law provides, in substance, that unless a contrary intent appears in the will or deed, all stock dividends whether ordinary or extraordinary are payable to the principal of the trust.[22] This statute, however, applies only to trusts created after 1926, the date of its enactment.[23] Stock dividends payable to a trust created before this date must be apportioned in accordance with the "Osborne rule."[24] Under this rule the value of the stock at the inception of the trust is described as the "intact value." This value is so described because it is to remain un-

19. 8 A.D.2d 158, 187 N.Y.S.2d 306 (1st Dep't 1959).
20. 15 Misc. 2d 225, 177 N.Y.S.2d 410 (Surr. Ct. 1958).
21. Ametrano v. Downs, 170 N.Y. 388, 63 N.E. 340 (1902).
22. N.Y. Per. Prop. Law § 17(a).
23. Equitable Trust Co. v. Prentice, 250 N.Y. 1, 164 N.E. 723 (1928).
24. "The intrinsic value of the trust investment is to be ascertained by dividing the capital and the surplus of the corporation existing at the time of the creation of the trust by the number of shares of the corporation then outstanding, which gives the value of each share, and that amount must be multiplied by the number of shares held in trust. The value of the investment represented by the original share after the dividend has been made is ascertained by exactly the same method. The difference between the two shows the impairment of the corpus of the trust." In re Osborne, 209 N.Y. 450, 485, 103 N.E. 823 (1913).

impaired by any subsequent distribution of income.[25] The application of this rule was the problem before the Court of Appeals in *In re Bingham's Will.*[26]

By a trust deed dated September 7, 1915 the settlor created a trust, the income of which was payable to William Bingham, II, for life. Upon his death the trust terminated and the corpus was to be distributed to the living descendents of the settlor's sister. The settlor made no provision in the trust deed for the distribution of stock dividends. As far as is pertinent to this case the trust contained 26,500 shares of Standard Oil Company of Indiana, and 4,100 shares of Borg-Warner Corporation.

During the life of the income beneficiary these two corporations distributed extraordinary stock dividends. In each case the corporation transferred to its capital stock account the entire amount of its capital surplus. The balance needed in the capital stock account to cover the entire stock distribution was drawn from the earned surplus account. The trustee determined that the percentage of the stock distribution which represented capital surplus, was not a stock dividend as contemplated by the Osborne rule. This amount, therefore, was allocated to the principal of the trust. The percentage of stock which represented money transferred from earned surplus was then allocated to income after having determined that doing so would not impair the corpus.

Upon the death of the income beneficiary, the surviving children of the settlor's sister became entitled to the corpus. The trustee brought a proceeding pursuant to Article 79 New York Civil Practice Act, to settle its accounts. The executors of the life beneficiary objected to the allocation made by the trustee. They contended that all of the stock dividends should have been allocated to income whether derived from capital surplus or earned surplus except in so far as the principal of the trust might be impaired. The trial court, however, sustained the trustees determination holding that stock derived from capital surplus is in essence a stock split which amounts to a redistribution of the corporations stock and not a distribution of earnings.[27] The Appellate Division affirmed the order of the trial court, but modified by deleting a provision appointing a referee to hear and report on the appropriate accounting methods to be used.[28] The Court of Appeals affirmed the order of the Appellate Division as modified.[29]

Since both parties accepted the applicability of the Osborne rule, the only issue before the court was whether the allocation of stock dividends by a trustee should be determined by considering the source of the stock dividends.

The executors of the life beneficiary argue that the Osborne rule is a limitation of the rights of principal. Their position was that as long as the intact value is not impaired all other corporate distributions belong to income.

25. In re Waterhouse's Estate, 308 Pa. 422, 162 A. 295 (1932).
26. 7 N.Y.2d 1, 194 N.Y.S.2d 465 (1959).
27. 11 Misc. 2d 367, 161 N.Y.S.2d 217 (Sup. Ct. 1957).
28. 4 A.D.2d 937, 167 N.Y.S.2d 999 (1st Dep't 1959).
29. Supra note 26.

The Osborne rule, they claim, is based on the presumption that the settlor intended to confer every benefit upon the income beneficiary since normally the life beneficiary is the principal object of the settlor's bounty. They also point out that "Capital, capital surplus, and earned surplus are merely bookkeeping entries on the records of the *corporation.* They cannot govern the substantive rights of those interested in a *trust.* What is capital to the corporation, may be income to the trust, and what is income to an ordinary shareholder may be corpus to a trust shareholder."[30]

This was rejected by the majority of the Court which felt that the Osborne rule was designed as a safeguard on the rights of principal and a limitation on the rights of income. Even though a corporation may have sufficient earnings subsequent to the creation of the trust to cover the distribution, the nature and source of the dividend must be considered and the court will not assume the distribution come from earned surplus. For example, extraordinary distributions of corporate property acquired by the corporation before the creation of the trust or a distribution of earnings accumulated before the trust was created should go to trust principal. On the other hand, when *earned surplus* is capitalized and stock issued, this stock may be allocated to income on the theory that the stock dividend is in essence a distribution of earnings even though the earnings are being retained in the corporation. This rule is advantageous to the income beneficiary in that it gives him a proportionate interest in all the capital assets; and it is also possible for the value of the stock distributed to be greater than the earnings capitalized. Also where the trustee has a slight majority of the voting stock giving him control of the corporation, it would be possible by allocating a stock dividend to income to shift the control of the corporation away from the trustee. Therefore, the rule should be limited to its present application.

In the instant case, since the applicability of the Osborne rule was not put in issue by the parties, the result reached by the majority is justified. However, the fundamental difficulty lies in the acceptance of the rule itself regardless of which interpretation it is given. The New York Legislature recognized the fact when it passed Section 17(a) of the Personal Property Law. Unfortunately, this only covers extraordinary dividends of stock to trusts created after 1926. It is submitted that if the applicability of the Osborne rule comes squarely before the court it should be overruled in favor of a rule more in line with the present legislative declaration.

PAYMENTS TO ESTATE BENEFICIARIES BEHIND THE IRON CURTAIN

In re Geiger's Estate[31] was an appeal from a refusal to release funds from an estate for the purpose of sending relief packages to estate distributees in

30. Id. at 23, 194 N.Y.S.2d 481 (dissent).
31. 7 N.Y.2d 109, 195 N.Y.S.2d 831 (1959), a 5-2 decision, the minority dissenting to both the holding denying the assignment and the refusal of a hearing to permit release of the funds for the beneficiaries.