

1942

TRUSTS - DIVISION OF PROCEEDS FROM UNITED STATES SAVINGS BONDS BETWEEN LIFE TENANT AND REMAINDERMAN

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Recommended Citation

William H. Shipley, *TRUSTS - DIVISION OF PROCEEDS FROM UNITED STATES SAVINGS BONDS BETWEEN LIFE TENANT AND REMAINDERMAN*, 40 MICH. L. REV. 1113 (1942).

Available at: <https://repository.law.umich.edu/mlr/vol40/iss7/14>

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TRUSTS — DIVISION OF PROCEEDS FROM UNITED STATES SAVINGS BONDS BETWEEN LIFE TENANT AND REMAINDERMAN — Testator devised the residue of his estate in trust to pay the income to his wife for life and on her death to distribute the corpus to the children of the testator. The trustee bought ten-year bonds of the United States Government known as United States Savings Bonds. The bonds did not bear interest payable at stated intervals, but were sold at a price sufficiently below their maturity value to yield a return equal to 2.9 per cent per annum, compounded semi-annually, if the bonds were held for the full ten years. The holder of such bonds may present them for redemption by the United States at any time after they have been outstanding sixty days. Redemption is made in accordance with a schedule which, after the first year, provides an increased redemption price every six months which is sufficiently in excess of the original purchase price to yield to the holder a return of 1.33 per cent to 2.84 per cent per annum, depending upon how early in the ten-year period the bonds are redeemed. The trustee proposed to pay the life tenant, from available cash belonging to the corpus, the amount of each six months' increment in redemption value according to the schedule set out in the bond. The remainderman contended that since the bonds were purchased on a discount basis any increment in value belonged to the corpus, or that if the increment was income, it was not distributable income until it came into the possession of the trustee when the bonds were redeemed. *Held*, the increment on the bonds is distributable income. *In re Wehmer's Will*, 238 Wis. 557, 300 N. W. 241 (1941).

When bonds are purchased as a premium, and a contrary intention of the settlor is not shown, most courts hold that the corpus of the estate must be kept intact by amortizing the premium out of interest received.¹ It has been contended

¹ *New England Trust Co. v. Eaton*, 140 Mass. 532, 4 N. E. 69 (1886); *In re Wells' Estate*, 156 Wis. 294, 144 N. W. 174 (1914); *Estate of Gartenlaub*, 185 Cal. 648, 198 P. 209 (1921). In *Shaw v. Cordis*, 143 Mass. 443, 9 N. E. 794 (1887), the testator indicated that the premium should not be amortized.

that the logical converse application of the rule² would allow the life tenant the saving realized when bonds are purchased at a discount, since bonds are usually sold at a discount because the interest rate of the bond is lower than the current market rate for securities of equal grade. Therefore the appreciation was contracted for and represents income earned and retained in the investment.³ But decisions dealing with the disposition of gains realized by a trustee from bonds purchased at a discount almost unanimously reject this logic and agree that the gain belongs to the corpus of the estate.⁴ The courts have reached this conclusion for two principal reasons. One is the possibility that factors other than the interest rate may have determined the discount price of the bond.⁵ The other reason derives from the fact that if payment to the life tenant of the proportionate increment of the discount is made at each interest-paying period, the installments would have to be paid from funds belonging to the corpus. The corpus of the estate would therefore suffer a loss if the bonds were not redeemed at par, and there is no certainty that redemption at par will be made.⁶ The first reason for denying the increment in the value to the life tenant does not apply to the bonds in the principal case. Since the savings bonds bear no interest to be paid at regularly stated intervals, the increment in value must be the interest for the use of the money. Therefore, there can be no argument that the discount is based upon factors other than compensation for a low interest rate. Nor is the second reason applicable, because it must be assumed that redemption will be made at the price stated in the bond. Hence there can be no objection to the trustee's purchasing the increment in value for the corpus in order to make possible a steady flow of income to the life tenant. The decision in the principal case makes United States Savings Bonds a feasible form of investment for trust funds.

William H. Shipley

² *Hemenway v. Hemenway*, 134 Mass. 446 (1883); 2 PERRY, TRUSTS, 7th ed., § 548b (1929).

³ Edgerton, "Premiums and Discounts in Trust Accounts," 31 HARV. L. REV. 447 (1918); 4 BOGART, TRUSTS AND TRUSTEES, § 830 (1935).

⁴ *Estate of Gartenlaub*, 198 Cal. 204, 244 P. 348 (1926); *In re Houston's Will*, 19 Del. Ch. 207, 165 A. 132 (1933); *Matter of Gerry*, 103 N. Y. 445, 9 N. E. 235 (1886); *Wood v. Davis*, 168 Ga. 504, 148 S. E. 330 (1929); *Old Colony Trust Co. v. Comstock*, 290 Mass. 377, 195 N. E. 389 (1935).

⁵ "Purely accidental circumstances may be . . . important factors." *In re Houston's Will*, 19 Del. Ch. 207 at 213, 165 A. 132 (1933); *Old Colony Trust Co. v. Comstock*, 290 Mass. 377, 195 N. E. 389 (1935).

⁶ *Old Colony Trust Co. v. Comstock*, 290 Mass. 377, 195 N. E. 389 (1935); *In re Houston's Will*, 19 Del. Ch. 207, 165 A. 132 (1933). Payment of a proportional part of the discount at intervals would be payment of income before it is realized. The trustee is under no duty to do this and it has not been urged that he should. But the courts have proceeded on the assumption that this was the method contemplated. *Wood v. Davis*, 168 Ga. 504, 148 S. E. 330 (1929); *Matter of Gerry*, 103 N. Y. 445, 9 N. E. 235 (1886); *Old Colony Trust Co. v. Comstock*, 290 Mass. 377, 195 N. E. 389 (1935).