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TRUSTS-DISPOSITION BETWEEN LIFE TENANT AND REMAINDERMAN OF PROCEEDS OF BONDS BOUGHT AT A PREMIUM OR DISCOUNT

TRUSTS—DISPOSITION BETWEEN LIFE TENANT AND REMAINDERMAN OF PROCEEDS OF BONDS BOUGHT AT A PREMIUM OR DISCOUNT—Trustees under a will purchased two lots of bonds at a premium, one of which had a call date and price; a callable preferred stock at a price above the call price; and bonds at a discount. The trustees amortized the premium bonds to the maturity date in one case and to the call date in the other. The stock was amortized over a period of five years to the call price. The life tenant claimed the right to be paid discount accumulated on the bonds bought at a discount. *Held*, that the action of the trustees as to amortization of both lots of premium bonds was proper; that there was no basis for amortization on stock, though callable, as on bonds; that accumulation on bonds bought at a discount could not be paid to the life tenant. *Old Colony Trust Co. v. Comstock*, (Mass. 1935) 195 N. E. 389.

In another recent case, a trustee received from the executor bonds valued at a premium and made amortization charges against interest received on coupons. *Held*, to allow such charges was error. *Boston Safe Deposit and Trust Co. v. Williams*, (Mass. 1935) 195 N. E. 393.

The rule appears to be well established that the trustee purchasing bonds at a premium should amortize the premium, i.e., deduct from interest on coupons periodic amounts sufficient to insure that the corpus of the trust will be unimpaired when the bond reaches maturity and is paid at par.[1] A distinction is made as in

[1] 48 A. L. R. 689 (1927); 4 BOGERT, TRUSTS & TRUSTEES, §§ 830-831 (1935); 2 PERRY, TRUSTS, 7th ed., § 548 (a) (1929). See especially New England Trust Co. v. Eaton, 140 Mass. 532, 4 N. E. 69, 54 Am. Rep. 493 (1886), and In re Stevens, 187 N. Y. 471, 80 N. E. 358, 12 L. R. A. (N. S.) 814 (1907), the latter making the

the *Boston Safe Deposit* case, however, where the trustee does not buy the bonds but receives them from the executor as part of a trust created by the will.[2] There appears to be no authority for the amortization of stock even though callable.[3] Nor has the question of amortization of premium bonds to the call date and price received much attention.[4] Though the courts have generally agreed to the amortization principle for premium bonds, they refuse to admit that the life tenant has any corresponding right to the accumulation of discount.[5] They have been dis-

rule of amortization imperative and requiring clear expression of contrary intent to overcome this rule.

[2] 4 A. L. R. 1249 (1919); 16 A. L. R. 520 (1922); TRUSTS RESTATEMENT, § 231 (1935). Shaw v. Cordis, 143 Mass. 443, 9 N. E. 794 (1887), expresses the view of the great weight of authority. For a dissent from the prevailing view, see Vierling, "Interest on Investments, and Amortization of Premiums Paid and Accumulation of Discounts Allowed Thereon," 5 ST. LOUIS L. REV. 134 at 146-147 (1920), and note the admission of Rugg, C. J., in the Boston Safe Deposit case (195 N. E. 393 at 394) that the distinction "is not too wide in logic." See 4 BOGERT, TRUSTS AND TRUSTEES, §§ 830-831 (1935).

[3] In the case of stocks there may be a question as to the right of a life tenant to an increase in value from the withholding of earnings or nearness of a dividend period, but the purchase of a stock above or below par is in no sense comparable to the purchase of a bond at a premium or a discount, even though the stock be callable. The factors of interest rate on the bond, maturity date, and the prevailing interest rate are all required to apply amortization principles. Even with a preferred stock one of these factors is missing: a fixed date of maturity and payment when the "loan" must be paid. The stock represents ownership; there is no contractual agreement for repayment. See the Old Colony case, (Mass. 1935) 195 N. E. 389 at 392 and 13 A. L. R. 1004 (1921), 56 A. L. R. 1315 (1928), 81 A. L. R. 542 (1932).

[4] The reasoning of the Old Colony case is not wholly convincing. Vierling, "Interest on Investments and Amortization of Premiums Paid and Accumulation of Discounts Allowed Thereon," 5 ST. LOUIS L. REV. 134 at 144-145 (1920), maintains a contrary view. Amortization to the call price and date is certain to protect the remainderman but may be unfair to the life tenant. No general rule can be made. The desirability of amortization on such a basis depends on the likelihood that the bonds will be called instead of being allowed to run to maturity. See HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS, p. 392 (1929), suggesting the rule laid down in the Old Colony case.

[5] Old Colony Trust Co. v. Comstock, (Mass. 1935) 195 N. E. 389; Townsend v. United States Trust Co., 3 Redf. (N. Y.) 220 (1877), no distinction drawn between accidental increase and contractual increase from approach to maturity; Hemenway v. Hemenway, 134 Mass. 446 (1883), dictum, but Holmes, J., indicates, pp. 448-449, that if the life tenant can claim amortization, he can also claim accumulation; In re Gerry, 103 N. Y. 445, 9 N. E. 235 (1886), no evidence when bonds on which accumulation was claimed were purchased, and therefore no basis for determining accumulated value at time of sale and life tenant's rights; Hite's Devisees v. Hite's Executor, 93 Ky. 257 at 269 (1892), dictum; In re Gartenlaub's Estate, 198 Cal. 204, 244 P. 348, 48 A. L. R. 677 (1926); Wood v. Davis, 168 Ga. 504, 148 S. E. 330 (1929), attempts to draw an analogy between stock dividends and discount; In re Houston's Will, 19 Del. Ch. 207, 165 A. 132 (1933), easily the best presentation of the "practical" view adopted by the courts regarding discounts as opposed to the "logical" view urged by text writers and

turbed, in considering the accumulation of discount problem, by the seeming difficulty of finding funds with which to pay discount and the possibility that the corpus might be impaired if the bond did not in the end pay out at par.[6] It is not necessary, however, that discount be added to each payment of interest made to the life tenant. For accounting purposes the discount bond should be periodically written up in value, but the discount, though earned, cannot be termed realized, wholly or partially, until the bond is paid at par or is sold for more than its original discounted price. It is not necessary to sell trust funds or keep them on hand to care for accumulation.[7] The courts also insist on the importance of a simple and clear rule for trustees,[8] but it is submitted that accumulation of discount requires no greater mathematical analysis than amortization of premiums, which is generally insisted upon. It would seem reasonable that the business view should prevail in this whole field. The basis on which bonds of the quality required for trust investment are bought and sold in the market is *yield* and not the interest purported to be paid on the face of the bond.[9] Ultra conservative business men who want only the safest bonds will buy both four and six per cent similar maturity bonds of a company whose credit is beyond question. The prevailing rate of interest being five per cent, the four per cent bond will sell at a discount and the six per cent at a premium, the yield on both being five per cent. The net return on the money invested is the significant thing. Only where the bond is bought at par will coupon interest and real return be equal.[10] The approach to par at matur-

others. For the "logical" approach, see Edgerton, "Premiums and Discounts in Trust Accounts," 31 HARV. L. REV. 447 (1918); 48 A. L. R. 689 (1927); 2 PERRY, TRUSTS, 7th ed., § 548 (b) (1929). Compare BOGERT, HANDBOOK OF THE LAW OF TRUSTS 392-393 (1921) with 4 BOGERT, TRUSTS AND TRUSTEES, § 830 (1935).

[6] Old Colony case, (Mass. 1935) 195 N. E. 389 at 392; In re Gartenlaub's Estate, 198 Cal. 204, 244 P. 348, 48 A. L. R. 677 (1926). Premiums are amortized; discounts, accumulated. The courts and others sometimes fail to use the accepted accounting terminology. Accumulation involves the making of periodic book entries representing discount earned though not realized, which will show in an increased book value of the bond and will bring the accumulated price to par at maturity date. At any given date before maturity on which the bond might be sold, this accumulated book value would indicate the amount of discount realized. The whole discount will be realized if the bond is paid at par on maturity.

[7] Edgerton, "Premiums and Discounts in Trust Accounts," 31 HARV. L. REV. 447 at 469 (1918); 48 A. L. R. 689 at 706 (1927); In re Houston's Will, 19 Del. Ch. 207, 165 A. 132 (1933); 4 BOGERT, TRUSTS AND TRUSTEES, § 830, pp. 2428-2429 (1935).

[8] "The practical advantages likely to flow from a simple rule, easy of comprehension and application, apparently based on experience and avoiding the possibility of impairment of the principal fund, overbalance the benefits of logical consistency." Old Colony case, (Mass. 1935) 195 N. E. 389 at 393.

[9] In re Stevens, 187 N. Y. 471, 80 N. E. 358, 12 L. R. A. (N. S.) 814 (1907).

[10] Edgerton, "Premiums and Discounts in Trust Accounts," 31 HARV. L. REV. 447 at 455-456 (1918). The example used shows equally well how unfairly the life tenant may be treated if amortization of premiums is allowed, but not accumulation. Assume a purchase for life tenants *A* and *B* of two bonds purporting to pay four per cent and six per cent respectively but otherwise alike, the prevailing rate being five per cent. *A* will receive slightly more than four per cent on the amount actually invested, but, without

ity of such bonds is not accidental but mathematical with both discount and premium.[11] The present abandonment of logic in the decisions, allowing as they do for amortization but not accumulation, seems hardly justified on the reasons thus far advanced by the courts.[12]

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accumulated discount, something less than five per cent. *B* will receive something less than six per cent but, even with amortized premium deducted, will never receive less than five per cent. The discrepancy will thus depend on the whim of the trustee. See Black, "Amortization—an Unsettled Question in Trust Accounting," 17 MASS. L. Q. 81 at 89 (1932), indicating the varying practices of two large trust companies, one of which by its practice would have constantly favored the life tenant, the other the remainderman.

[11] In re Stevens, 187 N. Y. 471, 80 N. E. 358, 12 L. R. A. (N. S.) 814 (1907). See also PATON, ACCOUNTING 364-366 (1926).

[12] For recent discussion of the general problem, see 47 HARV. L. REV. 143 (1933) and 48 HARV. L. REV. 1162 at 1194 (1935). The deliberations of the Commission on Uniform State Laws leading to the adoption of the Uniform Principal and Income Act are very interesting. The act was drafted by Dean Clark of the Yale Law School and in its first draft contained provision for both amortization and accumulation in all cases where premiums and discounts did not approximately balance. Later drafts and the final act cut out both provisions. This decision resulted from a study of 39 trust companies, 12 of which did not amortize premiums and all of which disapproved of accumulation. The committee concluded that, (1) amortization was not practicable or necessary where small funds were involved, (2) that no absolute requirement of amortization in all cases ought to be made by statute, (3) that accumulation of discount meant accounting difficulties, (4) that no amortization should be allowed unless accumulation were also permitted, (5) that therefore neither should be allowed. It would seem that the Commissioners have given undue weight to the convenience of the trust companies, most of which were in any case already using amortization principles, and not enough to the fair treatment of the very persons for whom the trusts were created. Up to 1935 the act had been adopted in no state, though Oregon has a similar act adopted prior to final action by the Commissioners. Oregon Laws, 1931, c. 371 at p. 731. HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS, pp. 211-212 (1928); 290-292 (1929); 346 (1930); 325-337, esp. at 332 (1931).