Trust Accounting

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TRUST ACCOUNTING

Upon receipt by the testamentary trustee of the distribution from the executor one of the immediate problems of the trustee is to determine what is to be included in the inventory and at what value. Since the adoption of the amendment to the Uniform Principal and Income Act in Wisconsin, it would seem that the entire distribution to the trustee should be considered corpus except for that portion of the distribution which is net probate income and also should be treated as trust income. Neither statutes nor Wisconsin cases appear to indicate what value is to be used as inventory value by the trustee, but it seems to be the practice of trustees to simply continue the valuation assigned by the appraisal during probate. After the trust is established, whether testamentary or inter vivos, the trustee must, of course, deal with problems of allocation of subsequent receipts and disbursements to principal or income and apportionment between successive trust beneficiaries.

Money or property received as rent of realty or hire of personalty, corporate dividends (other than in the shares of the declaring corporation), and interest are generally credited to the income account. Receipts of money or property obtained on the transfer (except by lease) of property forming a part of the principal, as loan repayments, in liquidation of a corporation, as proceeds of property taken by eminent domain, as proceeds on property insurance, and any changes in the form of principal are generally credited to the principal account.

CORPORATE DISTRIBUTIONS

1. Stock Dividends, Splits and Rights

A major controversy has long existed on whether or not the principal or income beneficiary of a trust should benefit from a corporate stock dividend in the declaring corporation. The "Massachusetts rule" arbitrarily allocates cash dividends to income and stock dividends to principal. The basis for the rule is its practicality and convenience for the trustee because the trustee can simply rely on the form of the

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1 Wis. Stat. §323.01(1) (1961) requires the testamentary trustee to file with the county, "a true inventory of all the goods, chattels, rights, credits, and estate so devised or bequeathed."
2 Wis. Laws 1961, ch. 57 established Wis. Stat. §231.40(3a) (1961) ; Uniform Principal and Income Act §3(3) (a).
3 Wis. Stat. §231.40(3a) (c) (1961).
4 Where the trust is to consist of a specific amount of property, or of prorata shares of the residue, a reappraisal at the time such property becomes part of the trust appears to be the common practice, however.
5 There is no statutory requirement of an inventory for inter vivos trusts but presumably the settlor and trustee agree on the valuation of the assets when the trust is established. This may also be necessary for gift tax purposes.
6 Wis. Stat. §231.40(3) (a) (1961) ; Uniform Principal and Income Act §3(1).
7 Wis. Stat. §231.40(3) (b) (1961) ; Uniform Principal and Income Act §3(2).
dividend in order to determine the recipient of the benefit. The "Pennsylvania rule," on the other hand, looks to the source of the dividend, whether it be from retained earnings or from capital surplus and whether or not the amount from which the stock dividend was declared was accumulated prior to or after the commencement of the interest of the income beneficiary. While this rule is sound in its equity, yet the burden upon the trustee in analyzing balance sheets and profit and loss statements is substantial. Under a third theory, known as the "Kentucky rule," a stock or cash dividend is allocated to the person entitled to receive the income at the time without regard to when it was earned. Wisconsin followed the Pennsylvania rule prior to the adoption of the Uniform Principal and Income Act.

With the passage of the Uniform Act in Wisconsin, however, the "Massachusetts rule" was adopted and "all dividends on shares of a corporation forming a part of the principal which are payable in the shares of the corporation shall be deemed principal." The allocation of stock dividends in the declaring corporation to principal is sound. As pointed out by the Oregon court in Stipe v. First National Bank, which followed the Uniform Act and allocated stock dividends to principal:

A stock dividend takes nothing from the property of the corporation and adds nothing to the interests of the shareholders. The property of the corporation is not diminished. The stockholders' interests are not increased. Their proportional interests remain the same. The only change is in the evidence which represents a given stockholder's interest, that is, the new shares representing the same proportional interest that the original shares represented before the issue of the stock dividend. In short, the corporation is no poorer and the stockholder is no richer than they were before. A stock dividend is, therefore, not in any true sense a dividend at all. Its issuance is, in the last analysis nothing more than an incident or process in corporation bookkeeping.

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9 Earp's Appeal, 28 Pa. 368 (1859).
10 Cox v. Gaulbert's Trustee, 148 Ky. 409, 147 S.W. 25 (1912).
11 Soehnlein v. Soehnlein, 146 Wis. 330, 131 N.W. 739 (1911); Miller v. Payne, 150 Wis. 534, 136 N.W. 811 (1912); Estate of Merrill, 195 Wis. 84, 213 N.W. 641 (1927); Will of Jenkins, 199 Wis. 131, 225 N.W. 733 (1929); Estate of Paddock, 213 Wis. 409, 251 N.W. 229 (1933); Estate of Boyle, 235 Wis. 591, 294 N.W. 29 (1940).
12 Wis. Stat. §231.40(5)(a); Uniform Principal and Income Act §5(1). The Revised Uniform Principal and Income Act §6(a) does not change this rule. The American Law Institute has changed its position from the adoption of the "Pennsylvania rule" in Restatement, Trusts §236(b) (1935) to the "Massachusetts rule" in Restatement, Trusts §236(b) (Supp. 1948), the "Massachusetts rule" being continued in Restatement (Second), Trusts §236(b) (1959).
13 208 Ore. 251, 301 P. 2d 175 (1956).
14 208 Ore. 251, 301 P. 2d 175, 186 (1956).
In *Will of Allis*, the Wisconsin court followed the Uniform Act by allocating a two per cent stock dividend to principal. A query on the wisdom of the Act is raised at this point. Since the practice of issuing small stock dividends is quite common, owners of these stocks probably consider them in the nature of income. Settlors of trusts, unless the issue is brought to their attention, probably consider them in the same manner and their unannounced intent is that the benefit should go to the income beneficiary.

Another area where the Uniform Act has proved inadequate is where a corporation's policy is to declare periodic stock dividends. Such is true with many "growth stocks" which plow earnings back into the business rather than distribute them. The Uniform Principal and Income Act might label such stock as unproductive property where the yield is less than one per cent of inventory value or cost and such stock is held for more than one year. In such situations the income beneficiary is entitled to share in the net proceeds, based on a five per cent return formula, when the stock is ultimately sold. This section of the Uniform Act is subject to several objections. 1.) It only applies where "the trustee is under a duty to change the form of investment." Hence, the section should not apply where the "unproductive stocks" were unproductive at the time of purchase; otherwise the trustee either: a.) should not have purchased the property under the generally accepted prudent man rule, or b.) has the duty to sell immediately after purchase. 2.) A five percent rate of return is above the rate of return on trust investments in recent years. 3.) Perhaps the section does not even apply to stocks because not "realty or personalty."

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15 6 Wis. 2d 1, 94 N.W. 2d 226 (1959).
16 This problem was discussed by the National Conference of Commissioners on Uniform State Laws in the consideration of the 1962 Revised Uniform Principal and Income Act, but resistance to change "arose from a desire to avoid the research and computation which it would involve." Bogert, *The Revised Uniform Principal and Income Act*, 38 Notre Dame Law. 50, 54 (1962).
17 *Uniform Principal and Income Act*, §11. It has been suggested that in lieu of the one per cent and five per cent requirements, property is unproductive when income is produced substantially less than the current rate of return on trust investments and income's share should be determined on the current rate of return on trust investments. Restatements (Second), Trusts §241 (1959); 3 Scott, Trusts §241 (2d ed. 1956).
18 *Uniform Principal and Income Act*, §11(1); The Revised Uniform Principal and Income Act removes this qualification altogether.
19 Restatements (Second), Trusts §227 (1959), Bogert, Trusts and Trustees §611 et seq. (2d ed. 1960); 3 Scott, Trusts §227 (2d ed. 1956).
20 Ibid.
21 Browning, *Problems of Fiduciary Accounting*, 36 N.Y.U. L. Rev. 931, 948 (1961). Texas, Colorado, Kansas and Vermont have reduced the five per cent credit to income to four per cent. Vernon's Ann. Civ. St. art. 742 5 (b) 35; C.R.S. 53, 57-4-11, Kan. G.S. 1955 Supp. 58-911, 14 V.S.A. §3311. The Revised Uniform Principal and Income Act §12 reduced the credit to four per cent also.
22 Following "personalty" Texas adds "whether tangible or intangible property" Vernon's Ann. Civ. St. art. 7425 b-35. The Revised Uniform Principal Act...
Wisconsin legislature did not adopt this section of the Uniform Principal and Income Act, thus avoiding the aforementioned problems, but creating a further one since the income beneficiary can gain almost no benefit from the stock of a corporation pursuing a stock dividend policy. This being true, a trustee in Wisconsin who purchases or retains such stocks might violate the "prudent man rule" since:

[A] fiduciary shall exercise the judgment and care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their own funds, considering the probable income as well as the probable safety of their capital. [emphasis added]

It has been suggested that the Uniform Act should be amended to cover certain stock dividends declared in connection with a corporate reorganization, allocating such dividends to income. This situation would arise where a new issue of preferred stock is intended to compensate for dividends in arrears, but where the corporation lacks the cash to pay them.

A purely technical oversight in the Uniform Act is its failure to direct allocation in the case of a stock split. The Florida Court had no difficulty, however, in allocating a "2 for 1" stock split to principal in *Pentland v. Pentland*. A stock split does not increase the value of the interest nor represent any greater net worth in the corporation, nor result in any greater dividends. The *Pentland* case points out that even though the allocation is to corpus the remainderman gets no immediate right to this "increase" in corpus, but the title to the additional shares accrues to the trustee because of his legal title to the original shares, and the income from the new stock is given to the life beneficiary.

When the trustee receives "rights" enabling him to purchase additional shares, other securities or obligations in the corporation distributing the "rights," such "rights" and the proceeds from any sale of these "rights" are allocable to principal. This is merely a codifi-

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\(^{23}\) If a substantial part of the corpus consists of productive assets, the "prudent man rule" might be construed as relating to the aggregate of the investments and not to one single investment.

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cation of the previously existing law of *Estate of Merrill* which awarded the proceeds of the sale of stock rights to corpus.

It is a well-nigh universal rule that the benefit of a right given by a corporation to its stockholders to subscribe at par, or other fixed amount less than the intrinsic value, for a new issue of stock, whether sold or exercised by taking new stock is awarded to corpus and not to income, to the remainderman and not to the life tenant.

2. Cash, "Cash or Stock" Option Dividends, and Dividends in Kind

All dividends in cash are allocated to income under the Uniform Principal and Income Act. This changes the previously existing law in Wisconsin under *Estate of Boyle* which credited ordinary cash dividends to income and allocated extraordinary cash dividends between income and corpus. The burden upon trustees under this rule was substantial, as several factors had to be considered in order to determine whether a dividend was extraordinary and thus subject to allocation. These factors were six: (1) whether similar dividends have been declared with regularity in the past; (2) whether such dividends are regularly paid out of current earnings; (3) the frequency with which the dividends are declared; (4) the size of the dividend in relation to the market value of the shares at the time of the creation of the trust; (5) the designation, if any, placed upon it by the directors of the corporation; (6) the source of the earnings from which the distribution is made. Such detailed considerations under the Wisconsin law prior to the adoption of the Uniform Act certainly invited trustees to seek court determination.

Where the trustee has an option of receiving a dividend in cash or in the stock of the declaring corporation, the dividend is allocated to income, irrespective of the trustee's choice.

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28 196 Wis. 351, 220 N.W. 215 (1928). *Estate of Merrill* overruled *Will of Barron* 163 Wis. 275, 155 N.W. 1087 (1916) which had held the trustee must apportion between the life beneficiary and remainderman according to the proportion of the surplus which was accumulated while the stock was held in trust.

29 *Estate of Merrill*, 196 Wis. 351, 355, 220 N.W. 215, 216 (1928).

30 Wis. Stat. §231.40(3)(a) (1961); Uniform Principal and Income Act §(3)(1). The same rule is adopted by the Revised Uniform Principal and Income Act §6(d).

31 235 Wis. 591, 294, N.W. 29 (1940).

32 In *Estate of Boyle*, 235 Wis. 591, 598, 294 N.W. 29, 32 (1940) the court followed Restatement, Trusts §236 (a), comment c, (1935).

33 In the Boyle case the court found that the cash dividends were paid with great regularity at frequent intervals over a period of years, that the dividends were normal and appear to have been regarded as ordinary dividends and so designated by the directors, and that although the dividends were not wholly from current earnings, but some from surplus, this circumstance alone did not make the dividend extraordinary. It was ordinary corporate procedure to invade surplus in order to pay dividends when current earnings were insufficient.

34 Wis. Stat. §231.40(5)(a) (1961); Uniform Principal and Income Act
The Oregon Court in *Stipe v. First National Bank of Portland*, while holding that an "option dividend" should be credited to income, recognized that the option must be a *true option*. In that case the remainderman claimed that the stockholders had previously decided to take the dividend in stock and that the option was one in form only for the purpose of securing a tax benefit. The presumption of *omnia rite acta praesumuntur* (which places the strong burden of establishing irregularity of corporate proceedings by clear and convincing proof) could not be overcome, however, in this case.

Dividends in kind are allocated to income. This includes not only "whiskey dividends" but also dividends in the shares of a corporation other than the declaring corporation. An exception to the last stated type of property was adopted in Wisconsin, presumably to cover situations where a corporation must divest itself of shares in another corporation of governmental anti-trust action:

[A]ny distribution of shares or other securities or obligations of corporations other than the distributing corporation, or the proceeds of sale or other disposition thereof, made as a result of a court decree or final administrative order by a governmental agency heretofore or hereafter entered ordering the distributing corporation to divest itself of the shares, securities or other obligations shall be deemed principal unless the distributing corporation indicates that the distribution is wholly or partly in lieu of an ordinary cash dividend in which case the distribution to the extent that it is in lieu of the ordinary cash dividend shall be deemed income.

Allocation of scrip dividends is not specifically covered by the Uniform Act. While it might be arbitrarily allocated to income under the general rule that

[all receipts of money or other property paid or delivered as . . . dividends on corporate shares payable other than in shares of the corporation itself . . . shall be deemed income . . .]

yet it is felt that the more logical view is to treat a scrip dividend as either principal or income depending upon the type of property for which the scrip is exchangeable.

§5(1). The *Revised Uniform Principal and Income Act* §6(d) is substantially the same.

35 *Supra* note 13.

36 *Wis. Stat.* §231.40(3)(a) (1961); *Uniform Principal and Income Act* §3(1); *The Revised Uniform Principal and Income Act* §6(d) has a similar rule.

37 *Wis. Stat.* §231.40(5)(a) (1961); *The Revised Uniform Principal and Income Act* §6(b)(3) adopts the Wisconsin change.

38 *Wis. Stat.* §231.40(3)(a) (1961); *Uniform Principal and Income Act* §3(1). *The Revised Uniform Principal and Income Act* §6(d) is to the same effect.

3. Capital Gains Dividends

In recent years, because of a generally rising stock market, investment companies have been distributing capital gains dividends to their stockholders. When the trustee receives these dividends, under Wisconsin law he must allocate these dividends to principal\(^4\) since Wisconsin changed the provision of the Uniform Principal and Income Act.\(^4\) Because the Wisconsin rule of allocation of capital gains dividends to principal is merely stated as an exception to the rule of allocation to income where there is an option on the part of a stockholder to receive a dividend in cash or stock of the declaring corporation, the statute assumes that investment companies never distribute capital gains dividends in the form of cash only.\(^4\) The statute does not cover the case of a "closed end" investment company which only declares capital gains dividends in cash. Following the general rule, such a capital gain dividend is allocated to income. Court decisions applying common law\(^4\) have held that capital gains dividends of investment companies are income since they represent the profits of the investment business (i.e. the situation is no different than a dividend of a corporation engaged in selling real estate). On the other hand the view has been taken that the gain realized by the investment company on the sale of securities is equivalent to the gain the trustees realize when he sells securities and that the mere medium of an investment company should not alter the allocation by the trustee.\(^4\)

Because Wisconsin allocates the capital gains dividends to corpus a substantial question might arise as to whether investment company securities are a prudent investment by the trustee\(^4\) since the regular cash dividends of an investment company are low (part of the investment return being the capital gain dividend), thus prejudicing the income beneficiary.\(^4\) A further problem arises when the trustee is

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\(^4\) Uniform Principal and Income Act §5(1). In the Revised Uniform Principal and Income Act §6(c) the Commissioners have reversed position and now follow the rule of allocation to principal.
\(^4\) At present it appears that investment companies do not distribute cash capital gain dividends without an option to take stock. The probable reason is their desire that the stockholder exercise the stock option, the investment company thus retaining the use of the stockholder's money. The Revised Uniform Principal and Income Act §6(c) allocates capital gains dividends to principal whether in the form of cash or an option to take new stock or cash or an option to purchase additional shares.
\(^4\) Putney, Capital Gain Dividends, 95 Trusts and Estates 22 (1956).
\(^4\) Supra notes 23 and 24.
in fact delegating his investment duty and incurring excessive costs of trust administration because charges are made by both the trustee and the managers of the investment company's portfolio.\textsuperscript{47}

4. Liquidating Dividends

Corporate distributions labeled by the corporation as liquidating dividends are allocated to principal as return of the stockholders' investment.\textsuperscript{48} The Uniform Act places emphasis upon the label given by the corporation, thus reversing the case of Estate of Mathews,\textsuperscript{49} which indicated that a liquidating dividend was apportionable. Neither Wisconsin nor the Uniform Principal and Income Act specifically refer to partial liquidation, but the general provisions of the statute\textsuperscript{50} would presumably allocate to principal.

When a corporation's assets are generally of a wasting nature (e.g. natural resources, patents, copyrights, leaseholds, or royalty rights), whenever that corporation distributes dividends it is returning some of its assets to the stockholder. This is in fact a partial liquidating dividend which should be allocated to principal.\textsuperscript{51} The Wisconsin Court recognized this fact in Estate of Wells\textsuperscript{52} and while the holding of that case was based on the intent of the settlor who had a large estate and wanted to preserve the corpus, the trust holding shares in lumber and mining corporations, the court stated that it was in accord with the general common law:

[I]t is to be remembered that there is a well established legal principle that, where a testator establishes a trust in property for the benefit of a life tenant with remainder over to another and the property is wasting nature, such as mining stock or land stock, the dividends on which represent in part a practical diminution of corporate assets, in the absence of a clear expression of the testator's intention to the contrary, the life tenant will be entitled to receive only the current rate of interest on the value of the trust property, and the remainder of the dividends will become a part of the principal of the trust fund, to be invested anew by the trustee.\textsuperscript{53}

Should a situation such as the Wells case arise in Wisconsin today it would be equitable to regard only that portion of a mining or

\textsuperscript{47} Id., Prof. Bogert feels that corporate trustees will, under the Revised Uniform Principal and Income Act, make more use of their own common trust funds.


\textsuperscript{49} 210 Wis. 109, 245 N.W. 122 (1933).

\textsuperscript{50} supra note 48. The Revised Uniform Principal and Income Act §6(b)(3) clarifies the problem of partial corporate liquidation dividends by allocating them to principal.

\textsuperscript{51} supra note 48.

\textsuperscript{52} 156 Wis. 294, 144 N.W. 174 (1913).

\textsuperscript{53} Estate of Wells, 156 Wis. 294, 304, 144 N.W. 174, 177 (1913).
lumber stock as principal which in fact represents a liquidation of the corporation's assets and regard the amount attributable to current earnings to income but it is not clear that such a result is permissible under our present statutes.  

PREMIUM AND DISCOUNT BONDS

1. Premium Bonds

The general common law rule and that recognized by the Wisconsin Court in In re Allis's Estate required the amortization of bond premiums, for the reason that to the extent of the premium paid, the bond is a wasting asset and the amount of the premium must be returned to principal out of the interest collected from acquisition to maturity or disposition. In other words, since the principles controlling a trustee's investments are safety and permanency with a view of securing a probable income for the beneficiaries, where a bond is bought at a premium, in essence, an amount is advanced out of principal to provide for a higher than normal return for a bond of that quality and face value. Amortization is proper to prevent a loss when the securities mature.

Payment of the whole annual income to the beneficiaries for life would produce a loss and diminish the principal, to the injury of the remainderman. This method of dealing with the fund operates most equitably between the life tenant and the remainderman, in that they mutually share the advantages and losses.

The Uniform Principal and Income Act as proposed and as adopted in Wisconsin, however, reverses the common law requirement of amortization of bond premiums by establishing the bond as principal at its inventory value or, if none, at market value or cost where purchased later regardless of par or maturity and that upon maturity or sale, the gain or loss falls upon principal. Apparently, the change was made because of the practical problems of accounting for small amounts by trustees. Trustees expressed this view through a questionnaire sent to them, feeling that amortization was too much trouble in the long run since premiums and discounts usually balance out. The

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54 Wis. Stat. §231.40(3)(a) (1961) and Uniform Principal and Income Act §3(1) announce the general rule that cash dividends are allocated to income.
55 Restatement (Second), Trusts §239, comment f (1959).
56 123 Wis. 223, 101 N.W. 365 (1904).
57 In re Allis's Estate, 123 Wis. 223, 101 N.W. 365, 368 (1904).
58 Estate of Wells, 156 Wis. 294, 309, 144 N.W. 174, 179 (1914) applied the amortization requirement to premium bonds which were part of the estate at the time of death, although this view is not universally accepted. Cf. Kemp v. Macready, 165 App. Div. 124, 150 N.Y. Supp. 618 (1914).
59 Wis. Stat. §231.40(6); Uniform Principal and Income Act §6; The Revised Uniform Principal and Income Act §7 does not change this rule.
question can be raised, however, if it would not be a violation of the trustee's duty to deal impartially between beneficiaries if a considerable portion of the trust estate was invested in premium bonds and the trustee did not amortize the premiums. Where the trustee simply purchases a few bonds at a premium, particularly where he also purchases bonds at a discount, failure to amortize would not appear to be a violation of the duty of impartiality.\textsuperscript{61}

2. Discount Bonds

The Uniform Act, in order to reduce trustee bookkeeping,\textsuperscript{62} prohibits increasing income payments where bonds are purchased at a discount.\textsuperscript{63} This is in accord with the general rule under common law, at least as to interest bearing securities issued at a discount\textsuperscript{64} since there was no fund out of which an accumulation could be made. Wisconsin, in the case of \textit{Will of Wehner}\textsuperscript{65} made an exception and allowed income payments in the case of non-interest bearing United States government bonds which were redeemable at any time under a schedule providing for an increased redemption price at regular intervals. Wisconsin retained the exception by changing the Uniform Principal and Income Act, by providing that the increment which occurs on bonds and other obligations issued on a discount "subject to a definite appreciation in value on a fixed schedule" shall be made available for income by a transfer of this amount from principal.\textsuperscript{66} The Wisconsin provision allowing allocation of the increment to income does not, therefore, because of the "fixed schedule" requirement appear to apply to those interest bearing bonds purchased at a discount which simply increase in market value as the instrument nears maturity.

The adoption of the Wisconsin amendment allows the trustee to purchase short term bills of the United States or United States savings bonds. In reality, the increase in value of the bond constitutes income

\textsuperscript{61} Supra notes 23 and 55.

\textsuperscript{62} Supra note 60.

\textsuperscript{63} Wis. Stat. §231.40(6) (1961); \textit{Uniform Principal and Income Act} §6.

\textsuperscript{64} Estate of Gartenlaub, 198 Cal. 204, 244 Pac. 348 (1926); \textit{Re Houston 19 Del. Ch. 207, 165 A. 132 (1933)}; Wood v. Davis 168 Ga. 504, 148 S.E. 330 (1929); Old Colony Trust Co. v. Comstock, 290 Mass. 377, 195 N.W. 389 (1935).

\textsuperscript{65} 238 Wis. 557, 300 N.W. 241 (1941). Wis. Stat. §320.01 (1941) codified this case until the statute was repealed by Wis. Laws 1959, ch. 233, the statute being unnecessary with the enactment of Wis. Stat. §231.40(6) (1957).

\textsuperscript{66} Other jurisdictions do not require the payment of the annual appreciations until they are collected at maturity or by other disposition and thus in fact realized. Code of Ala., tit. 58 §80 (1958); Col. R. S. 57-4-6 (1953); Conn. G. S. §45-114 (1958); Laws of N. M. ch. 138 §6 (1957); 60 Okl. St. Ann. §175.30 (1963); Vernon's Ann. Civ. St. (Texas) art. 7425b-30 (1960).

Trustee bookkeeping is substantially simplified in these states. The \textit{Revised Uniform Principal and Income Act} §7 adopts a third position as to when the increment should be paid out for non-interest bearing securities at a discount as the increment in value is distributable to the beneficiary at the time of the increment from the first principal cash available or, if none is available, when realized by sale redemption or other disposition.
and should be so allocated. Had Wisconsin failed to adopt the amendment, there would be serious doubt as to whether the trustee could purchase non-interest-bearing bonds since the income beneficiary would be discriminated against.\(^7\) The general provisions of both the Wisconsin Act and the Uniform Principal and Income Act in prohibiting amortization of bond premiums and increased income payments for discount bonds bears out the general purpose of providing a simple and convient method of administration of the trust estate.\(^8\) It would appear, however, that should a trustee allow too great a disproportion of one type of bond (either premium or discount) he is failing in his duty to be a prudent investor.\(^6\)

**Unincorporated Business**

Where the trustee receives a going business or farm property and it is either impossible or impractical to incorporate, the trustee is faced with the problem of allocating the profit from the business or farm. The Uniform Act\(^7\) is subject to the objection that it only covers sole proprietorships and not partnerships.\(^7\) A further problem is the difficulty of determining what constitutes a business (i.e. what about the operation of an apartment house).\(^7\) The Wisconsin legislature did not enact the sections of the Uniform Principal and Income Act which in essence direct allocation of net profit to the income beneficiary. This hiatus in the Wisconsin Act might well be filled by applying the general provisions of the Act,\(^7\) a result which might require accounting on an asset by asset basis rather than treating the business assets as a unit. On the other hand, should the court try to find a legislative intent to continue the common law which treats the unincorporated business as a unit, it would have to overcome the dilemma that the omitted Uniform Act sections are basically a restatement of the common law.\(^7\)

**Natural Resources and Wasting Assets**

1. **Natural Resources**

When part of a trust's corpus consists of property from which may be taken timber, mineral, oils, gas or other natural resources, the proceeds received on a lease shall be income, but if received as royalties for the permanent severance of the natural resources from the land they are principal.\(^7\) It has been claimed that this rule is inadequate

\(^{67}\) Supra note 23.
\(^{69}\) Wis. Stat. §231.40(7) (1961); supra note 23.
\(^{70}\) UNIFORM PRINCIPAL AND INCOME ACT §§7, 8.
\(^{71}\) Supra note 39, at 244.
\(^{72}\) Ibid.
\(^{73}\) Wis. Stat. §§231.40(3) (a), (b) (1962).
\(^{74}\) BOGERT, TRUSTS AND TRUSTEES §820 (2d ed. 1962).
\(^{75}\) Wis. Stat. §231.40(7) (1961); UNIFORM PRINCIPAL AND INCOME ACT §9.
since minerals can be extracted from the land, thus constituting waste to the remainderman, and yet the receipts will be allocated to the income beneficiary simply by camouflage the agreement as a lease although in substance it represents compensation for the severance or removal of natural resources from the land itself.\textsuperscript{76} The Uniform Act appears to change the common law with respect to tree farming. Under common law the proceeds of the sale of trees would be allocated to corpus unless the sale was an integral part of tree farming (i.e. where there is periodic cutting and a plan of reforestation). In the latter situation the timber so cultivated is thought of as merely part of the annual fruits of the land and hence goes to the income beneficiary.\textsuperscript{77} Generally, however, the Uniform Act does reflect the common law\textsuperscript{78} that such minerals as oil and gas are wasting assets subject to depletion and exhaustion by removal and hence not in the same category as rentals or income from normal recurring production of crops or the surface use of real estate, since after the oil or gas (or other mineral) is exhausted its value is gone and not subject to further recovery. The argument that such royalties and bonuses are considered income for federal income tax purposes (after depletion allowances) has generally been unavailing.\textsuperscript{79}

2. Leaseholds, patents, copyrights and royalty rights.

While the Wisconsin legislature did provide for natural resources,\textsuperscript{80} it did not specifically provide for other assets which are by their very nature wasting, such as leaseholds, patents, copyrights and royalty

\textsuperscript{76} Nossaman, The Uniform Principal and Income Act, 28 CAL. L. R. 32, 46 (1939).

\textsuperscript{77} 33 AM. JUR. Life Estates, Remainders §323 (1941); In First Nat. Bank of Mobile v. Wefel, 252, Ala. 212, 40 So. 2d 434 (1949), the Uniform Principal and Income Act was not applied because it has no retroactive effect in Alabama, and the common law tree farming exception was applied.

The Revised Uniform Principal and Income Act §§10, 2(a)(3) appears to remedy the problem of the tree farming exception by allowing the trustee to allocate “in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as those entitled to principal, and in view of the manner in which men of ordinary prudence, discretion and judgment would act in the management of their own affairs.”


\textsuperscript{79} Idd. Several states have amended the Uniform Act by setting aside a portion of receipts of royalties as depletion allowances and giving the rest to income. TEx. REV. Civ. Stats. art. 7425b.33 (1960); OKLA. STAT. ANN. tit. 60, §175.33 (1949); VT. Stats. Ann. tit. 14, §3309 (1958). The Revised Uniform Principal and Income Act §9 follows the Internal Revenue Code and allocates 27½% of gross receipts (but not over 50% of the net receipts) to principal as an allowance for depreciation. The balance after payment of expenses is income. While this treatment would only apply to depletable property acquired after the Revised Act becomes effective, “[i]t is believed to be a desirable recognition of the equities of the income beneficiary and the probable intent of the settlor, and to be in accord with the treatment of other assets which are subject to depletion, treated in section 11 of the new Act.” Bogert, The Revised Principal and Income Act, 38 NOTRE DAME LAW 50, 55 (1962).

\textsuperscript{80} WIS. STAT. §231.40(7) (1961).
rights. The drafters of the Uniform Act felt that settlor’s probable intent would be to give receipts from these assets to the income beneficiary:

[T]he probable intent of the creator of a fund for the benefit of a tenant and a remainderman is for as simple a system of distribution of his bounty as is possible, thus, detailed amortization plans and accounting practices requiring extensive bookkeeping as to each single item of a trust fund seemed hardly within the scope of the ordinary testator’s scheme of distribution. To take a single instance ... where a man leaves his estate to his wife and children for their lives, remainder to his grandchildren, it seems a reasonable assumption that he desires his income beneficiaries to receive in full all royalty receipts on books he has written rather than that an amortization fund should be set up out of the receipts from each book. This assumption as to the property owner’s intention makes possible a simple and comparatively easily administered scheme of administration.

While the section omitted in Wisconsin would not cover the problem where a corporation was interposed between the trustee and the wasting asset, the theory of the Uniform Act that the settlor intended to benefit the life beneficiary does not square with the previously existing “Wisconsin” view in Estate of Wells, which although it dealt with wasting natural resources with a corporation interposed between trustee and the assets, yet it did announce the view that the general intent of settlors would be to allocate the receipts from wasting assets in general to principal to be reinvested for the benefit of the income beneficiary.

Since the Wisconsin legislature failed to make specific provision for patents, copyrights, leaseholds and royalty rights, the general provisions of the statutes may apply. The interpretive problem is which of these general sections should apply? Are patents, copyrights, leaseholds and royalty rights “receipts of money or other property paid or delivered as rent or hire of personality ... or otherwise in return for the

81 The Uniform Principal and Income Act §10 allocates the return from these assets to income where the trustee is not under a duty to change the form of investment or 5% of the value of the property in income and the remainder in principal where the trustee is under a duty to change the form of investment.

For the trustee not to be under a duty to change it would appear that an express direction to retain would be necessary. Otherwise the trustee would have a duty to change the investment under the prudent investor rule because otherwise all the receipts would go to the life beneficiary while the corpus was wasting away.


83 Uniform Principal and Income Act §10.

84 Supra note 76, at 49.

85 Supra note 53.

86 Wis. Stat. §§231.03(a), (b) (1961).
use principal," use principal," and thus deemed income or are they "receipts of money or other property paid or delivered as the consideration for the sale or other transfer, not a leasing or letting, of property forming a part of the principal . . . or otherwise as a refund or replacement or change in form of principal" and thus to be deemed principal? The receipts concerning us here appear to be hybrids and the equitable allocation under Estate of Wells might well be the proper method particularly in view of the Wisconsin legislature's failure to meet the problem head on. A legislative intent not to disturb the common law is a reasonable interpretation.

Unproductive Property

The problem of unproductive (or at least "underproductive") property both under the Uniform Principal and Income Act and in Wisconsin, at least as to corporate stock, has been dealt with previously. Since Wisconsin rejected the section of the Uniform Principal and Income Act, dealing with unproductive property, the problem is again whether the legislature intending the general provisions of the Act to apply or whether the legislative intent was to continue the existing common law. A situation which may commonly face the trustee is that of real property left in the trust, where there is no direction to retain it, hence resulting in a duty in the trustee to dispose of the property as soon as it does not continue to produce a reasonable return for the income beneficiary. While the trustee may be under a duty to dispose of this property, yet there may be no market or a greatly deflated market requiring the prudent trustee to hold on to the property and wait until a reasonable price can be obtained for it. During this period when the trustee is holding the property before sale, carrying charges are incurred (e.g. taxes, repairs, maintenance). Should these expenses be charged against income or principal? If the property is ultimately sold at a profit, the net sale

87 Wis. Stat. §231.03(a) (1961).
88 Wis. Stat. §231.03(b) (1961).
89 This result is generally reached by the Revised Uniform Principal and Income Act §11 which eliminates the "duty to sell" problem present in the Uniform Act and allocates receipts from depleting assets other than minerals and timber, including leaseholds, patents, copyrights, royalty rights and rights to receive payments under deferred compensation, agreements, to income but not in excess of five per cent of the inventory value, the balance being allocated to principal.
90 Supra, Section on stock dividends, splits and rights.
91 Uniform Principal and Income Act §11.
92 Wis. Stats. §§231.40(3) (a), (b) (1961).
93 The Uniform Principal and Income Act §12 provides that expenses incurred both in disposing of and as carrying charges on unproductive property shall be paid out of principal. The Revised Uniform Principal and Income Act §§12, 13 appears to charge carrying costs against income, but then reimburse the income account out of principal at the time of the property's disposition.
proceeds exceeding the inventory value, should the income beneficiary share in the profits?294

Assuming for the moment that the general provision of the Act applies in Wisconsin, then the result would be a harsh one indeed for the entire net sale proceeds would be allocated to principal since "all receipts of money or other property paid or delivered as the consideration for the sale or other transfer . . . of property forming a part of the principal . . . shall be deemed principal. . . ."95 Hence, none of the profit would go to income. In addition, all the carrying charges might well fall upon income.96 The remainderman is unduly benefited because the delay in the sale of the property was so that it might bring a higher price and the income beneficiary is deprived of income during that period. Keeping this possible result in mind, the prudent trustee might be ill advised to hold on to unproductive property for a higher sale price because of the great burden upon the income beneficiary. As with the problem of certain wasting assets, however, the Wisconsin court might well find a legislative intent to continue the common law.

In Will of Des Forges97 the court indicated that where property is unproductive when it enters the trust it is usually not too difficult to find a manifestation of the intent of the settlor to retain the property or that the income beneficiary shall receive no income with respect to that property until it is sold and that he should thereafter receive only the income from the reinvested proceeds of the sale.98 But where property becomes unproductive during the administration of the trust, it would not be equitable for the entire loss to fall upon the income beneficiary; and the court held that proceeds of the sale should be

94 The Uniform Principal and Income Act §11 provides that the income beneficiary shares in the profit where the trustee was under a duty to sell and the yield on the unproductive property was less than one per cent of inventory value or cost and property was held for more than one year after it became unproductive. The amount credited to the income beneficiary is to the extent of the difference between the net proceeds (sale price less costs of selling and carrying charges) and an amount which had it been placed at simple interest would have returned five per cent interest of the period of unproductiveness. The Revised Principal and Income Act removes the duty to sell requirement and changes the five per cent rate to four per cent.

95 Wis. Stat. §231.40(3) (b) (1961).

96 Wis. Stat. §231.40(8) (a) (1961) charges all ordinary expenses to income and then lists specific items such as property taxes, mortgage interest, and ordinary repairs. This could be construed as classifying all specifically enumerated expenses as ordinary, even those connected with unproductive property. Wisconsin failed to enact that portion of the Uniform Principal and Income Act §12 which would charge carrying costs against principal, supra note 93.

97 243 Wis. 178, 9 N.W. 2d 609 (1945), motion for rehearing, 10 N.W. 2d 291 (1943).

98 Where real property was productive in the hands of the settlor, became unproductive during probate, and was unproductive in the hands of the trustees, the carrying charges should be paid out of the trust principal and not the residue of the personal estate bequeathed as a non-trust gift. Estate of Trowbridge, 244 Wis. 519, 13 N.W. 2d 66 (1944).
apportioned.\textsuperscript{99} The carrying charges originally paid out of income also were ordered reimbursed out of the proceeds of the sale. The equitable approach of the common law seems preferable to a literal application of the remaining general provisions of the Wisconsin statutes in this area.

\textbf{Expenses}

Ordinary expenses such as taxes, water rates, insurance premiums, mortgage interest, ordinary repairs, compensation of assistants and agents are chargeable to income.\textsuperscript{100} This is in accord with the common law.\textsuperscript{101} In \textit{Estate of Mathews}\textsuperscript{102} the Wisconsin Court charged ordinary and necessary repairs to income since the remainder was entitled to have the integrity of the corpus preserved.

In \textit{Linethal v. Birmingham Trust & Savings Co.},\textsuperscript{103} the Alabama Court elaborated on the meaning of "ordinary repairs" under the Uniform Principal and Income Act:

\begin{quote}
All ordinary repairs, such as unstopping of plumbing, replacing broken glass, inside painting or repapering, repairing of leaks, and the like shall be chargeable to the life tenant and shall be paid from the income of said estate.\textsuperscript{104}
\end{quote}

Other expenses such as investment costs, court costs, attorney's fees, other fees on accountings and maintaining or defending actions to protect the trust, costs of and assessment for improvements to the property, and tax on gain or profit defined as principal are chargeable to principal.\textsuperscript{105} This also is in accord with the common law.\textsuperscript{106} In \textit{Welch v. Welch},\textsuperscript{107} the Wisconsin Court stated:

\begin{quote}
If the improvements are permanent in character, the principal is benefited, the effect being merely to substitute one form of principal for another. It is therefore, fair that the cost for improvements should be paid for out of principal without amortization. While the beneficiary entitled to the income may receive a benefit from the improvements in the form of increased rentals, this is balanced by the fact that he no longer receives
\end{quote}

\textsuperscript{99} The Wisconsin Court, Wollangk et al. v. Jurgella 243 Wis. 178, 184, 9 N.W. 2d 609, 612, (1945) cited with approval \textit{Re}\textsuperscript{STATEMENT, TRUSTS} \S 241 (1935) which provides for apportionment giving the income beneficiary the current rate of return where income was substantially below the current rate of return. This rule is continued in \textit{Re}\textsuperscript{STATEMENT (SECOND), TRUSTS} \S 241 (1959).

\textsuperscript{100} Wis. Stat. \S 231.40(8)(a) (1961); Uniform Principal and Income Act \S (8) (1). The \textit{Re}\textsuperscript{vised Uniform Principal and Income Act} \S (a)(1) is to the same effect.

\textsuperscript{101} \textit{Re}\textsuperscript{STATEMENT (SECOND), TRUSTS} \S 233, comment e (1959).

\textsuperscript{102} 210 Wis. 109, 245 N.W. 122 (1933).

\textsuperscript{103} 249 Ala. 631, 32 So. 2d 368 (1947).

\textsuperscript{104} \textit{Id.}, 32 So. 2d at 372.

\textsuperscript{105} Wis. Stat. \S 231.40(8)(b) (1961); Uniform Principal and Income Act \S (8)(2). The \textit{Re}\textsuperscript{vised Uniform Principal and Income Act} \S (a)(2) is to the same effect.

\textsuperscript{106} \textit{Re}\textsuperscript{STATEMENT (SECOND), TRUSTS} \S 233, comment f-k (1959).

\textsuperscript{107} 235 Wis. 282, 290 N.W. 758 (1940).
income from that part of the principal which is expended in making the improvements.\textsuperscript{108}

A problem exists under both the Uniform Act and the Wisconsin version in that no provision exists for a depreciation reserve for depreciable property, in direct conflict with both accounting and tax practice and the actual fact that property, such as buildings, does depreciate in value even where ordinary repairs are made and maintenance expense incurred.

Numerous cases have held, though, that there is no privilege or duty to set up such a reserve,\textsuperscript{109} and it is believed that in view of the settlor's recognized partiality toward income beneficiaries and current low yields on improved realty, a settlor who desires to require or permit such a reserve should be required to state this intent expressly.\textsuperscript{110}

While the general provisions of the Act would appear to preclude the setting up of a depreciation account,\textsuperscript{111} where a corporation is interposed between the trust and the property, a depreciation reserve would be entirely proper. With the adoption of the Massachusetts rule of corporate distributions, it would appear that the life beneficiary would have no right to any of the depreciation reserve should the property subsequently be sold by the corporation at a profit.\textsuperscript{112}

Although it has been pointed out that the Uniform Act does not appear to permit the trustee to establish a depreciation reserve for property directly held by the trustee,\textsuperscript{113} the Minnesota Court in In re Wainer's Trust\textsuperscript{114} adopted a contrary rule that where depreciable buildings are acquired with trust funds after creation of the trust, the trustee should deduct from the gross receipts as an expense item an amount equal to the reasonable estimated depreciation of the cost value of the property.\textsuperscript{115}

\textsuperscript{108} 235 Wis. at 330, 290 N.W. at 780 (1940).
\textsuperscript{109} Citing In re Davies' Estate, 197 Misc. 827, 96 N.Y.S. 2d 191 (Survt. Ct. 1950), aff'd, 227 App. Div. 1021, 100 N.Y.S. 2d 710 (1950) (no duty); Laflin v. Commissioner, 69 F.2d 460 (7th Cir. 1934) (no privilege).
\textsuperscript{110} BOGERT, The Revised Uniform Principal and Income Act, 39 Notre Dame Law 50, 56 (1962).
\textsuperscript{111} Wis. STAT. §§231.40(3)(a), (b) (1961); UNIFORM PRINCIPAL AND INCOME ACT §§3(1), (2).
\textsuperscript{112} The Revised Uniform Principal and Income Act §13(a)(2) provides for a reasonable allowance for depreciation under generally accepted accounting principles (unless the property is used as a residence by a beneficiary where the property is purchased after the effective date of the Act.)
\textsuperscript{113} This reverses the rule of Estate of Mathews 210 Wis. 109, 245 N.W. 122 (1933).
\textsuperscript{114} Supra notes 110 and 111; BOGERT, TRUSTS AND TRUSTEES §289 (2d ed. 1962).
\textsuperscript{115} 117 N.W. 2d 224 (Minn. 1962).
The expense of the trustee's commissions was changed in Wisconsin by charging 75% to income and 25% to principal irrespective of whether the fee is computed upon income or principal. This is simpler than the allocation under the Uniform Principal and Income Act which charged to income all trustee's compensation except that based upon principal and allocated to principal that part of the commission computed upon principal. The problem eliminated by the Wisconsin Act was that of the annual management fee of the trustee based upon a percentage of the principal which would necessarily under the Uniform Act have been charged against principal.

**APPORTIONMENT BETWEEN SUCCESSIVE BENEFICIARIES**

When the interest of an income beneficiary terminates (usually by his death) any rents, interest, annuities and other periodic payments subsequently received by the trustee are apportionable between the deceased beneficiaries personal representative and any succeeding income beneficiary or, if none and the trust then terminates, the remainder entitled to the corpus. The exception to this general rule of apportionment arises in the case of dividends on corporate stock. The latter accrue on the record date, or if no record date on the date of declaration. Only dividends accruing before an income beneficiary dies pass to his personal representative. Some corporate fiduciaries prefer to avoid the detailed accounting required by these rules. Two states have also eliminated this detailed accounting.

**CONCLUSION**

Due to certain deficiencies in the Uniform Principal and Income Act and the "patchwork" adoption by the Wisconsin legislature, prob-
lems of interpretation and application exist. These problems are compounded by the fact that while the Uniform Principal and Income Act has been adopted in twenty-two states there is a dearth of case law construing the Act. The 1962 Revised Uniform Principal and Income Act is a substantial improvement over the old Act, but its mere existence, though unadopted, will raise problems of interpreting the old Act in situations where the Revised Act differs from the old Act in that the question will be whether the Commissioners intended merely to clarify the old Act or whether they intended to change it. In many areas the Revised Act is merely prospective, and even if adopted, problems under the old Act will continue.

The mere raising of problems is certainly not an end in itself, however, but rather a challenge to the draftsman who must provide for allocation and apportionment where the law in unclear. The draftsman has a further duty to the settlor of a trust in those areas where although the law may be clear, yet the settlor, upon being appraised of the consequences, may prefer either different rules of apportionment and allocation set forth in his trust instrument or a trustee with discretionary powers. In view of the interpretive problems under the Uniform Principal and Income Act in Wisconsin, it is questionable whether, if discretionary allocation by the trustee is desired, it should be limited to areas "where there is no provision made therefor by statute."  

ALLAN E. IDING

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123 One of the forms suggested by a Milwaukee trust company gives the trustee company the trustee a discretionary power to "determine upon allocations, charges or credits as between principal and income where there is no provision made therefor by statute, but regardless of any statute, to charge its customary annual fee to income."