St. John's Law Review

Volume 8
Number 2 *Volume 8, May 1934, Number 2*

Article 11

Illegal Accumulations--Undisposed-of Profits--Right to Proceeds

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is no mention made of the term "fiduciary," and such an important element would not have been overlooked.[21] We are inclined to think that a decision like the present one tends to create a confusion in the law of contracts, which law ought to be as definite and certain as is compatible with progress, if business men are to know how far the law will protect them in their contract dealings. We think that the primary intention of the parties ought not to have been changed when industrial development proved that the bargain of one of the parties was more advantageous than that of the other, but that the benefit ought to have been allowed to lay where it fell.

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ILLEGAL ACCUMULATIONS—UNDISPOSED-OF PROFITS—RIGHT TO PROCEEDS.

It is an oft-noted truth that the field of trusts and of their management has become one of the more important branches of the law. Certainly, in the matter of multiplicity and magnitude of litigation, trusts take a very high place. One need but scan the pages of the volumes containing the cases handed down by New York courts to come to this conclusion.

And so, it will not be amiss, despite the fact that this article deals primarily with the problem of the disposition of trust income funds which have been illegally accumulated or inadvertently ignored, to review some of the fundamental principles set up by the legislature and courts of our state as gauges for the determination of legality of accumulations of trust income.

Our statutes[1] provide that income of trusts of real or personal property may be accumulated for the benefit of a minor or minors *in being* at the time of the creation of the trust and that such accumulations must cease "at or before the expiration of their minority." If the accumulations are to commence at a period subsequent to the date of the trust instrument or the death of the person executing it, such commencement must be within the time permitted for the suspension of ownership of personal property and the vesting of future estates in realty. They must also begin during the minority of the infants to be benefited. *All other accumulations of income* (with certain noted exceptions[2]) *are void.*

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[21] *Id.* at 261; WILLISTON, THE LAW OF CONTRACTS (1926) 1. "Each party was free to act in his own interest restricted only by the stipulations of the contract." Patterson v. Meyerhofer, 204 N. Y. 96, 97 N. E. 472 (1912).

[1] N. Y. REAL PROP. LAW (1909) §61, N. Y. PERS. PROP. LAW (1909) §16.

[2] These deal with certain permitted accumulations of the income of trust funds for the benefit of religious, educational, charitable or benevolent corporations. Also, recent amendments have validated accumulations of income to be

A provision for accumulation for a period exceeding the minority of the person benefited is void *only* as to the period subsequent to the attainment of majority.[3] The prohibition of the statute may not be waived by consent of the parties involved.[4] Stock dividends issued upon any stock held in trust shall be principal and not income, and the addition of such dividend to the *corpus* of the trust shall not be deemed an accumulation.[5]

When the statute declares that the accumulation of income must be for the benefit of a minor, it means *totally* for his benefit. *Pray* v. *Hegeman* [6] presents a striking example of the absolute nature of this rule. In that case, the direction was to accumulate the income during the minority of the beneficiary. Upon attaining his majority, he was to get a *life estate* in the principal and the accumulated income. The court held this an invalid provision, since it did not give the accumulated income outright to the beneficiary, but gave him only a life interest in it. Accordingly, it was held that the beneficiary was entitled to ownership of all the accumulated income when he reached his majority.

Our courts, for a long time, have shown a strong tendency not to allow an invalid provision for accumulation to destroy an otherwise valid trust. Wherever it has been possible to strike out the invalid direction without destroying the structure of the trust or defeating the general scheme of the settlor, it has been done.[7] Where, too, the executor and trustee was directed by the will to pay certain indebtednesses either by sale of realty or by an accumulation of the rents and profits of the realty, the provision for the illegal accumula-

used for the payment of life, health, accident, or disability insurance premiums. And accumulations are permitted of the income of trusts of personal property created by employers "as part of a stock bonus plan, pension plan, disability or death benefit plan, or profit sharing plan, for the *exclusive* benefit of some or all of his employees, * * *," until such time as the employer deems necessary for the purposes of such plan. N. Y. PERS. PROP. LAW §16, as amended by L. 1928, c. 172; L. 1927, c. 681; L. 1927, c. 384.

[3] *Supra* note 1; Epstein v. Werbelovsky, 193 App. Div. 428, 184 N. Y. Supp. 330 (2d Dept. 1920).

[4] *In re* Schaefer's Estate, 112 Misc. 308, 182 N. Y. Supp. 732 (1920). But see Central Trust Co. v. Falck, 177 App. Div. 501, 164 N. Y. Supp. 473 (1st Dept. 1917), *aff'd,* 223 N. Y. 705, 120 N. E. 859 (1918). There the decision was to the contrary. However, Surrogate Foley, in the Schaefer's Estate case, points out that the Falck decision was due to the strong element of laches present in the case, along with the fact that several decrees of courts had already intervened and had considerably affected the status of the situation. He cites as authority for his decision, Carrier v. Carrier, 226 N. Y. 114, 122, 23 N. E. 135 (1919).

[5] N. Y. PERS. PROP. LAW §17a (added by L. 1922, c. 452, as amended by L. 1926, c. 843).

[6] 92 N. Y. 508 (1883).

[7] Dodge v. Pond, 23 N. Y. 69 (1861); Barbour v. DeForest, 95 N. Y. 13 (1884); *In re* Megrue, 170 App. Div. 653, 155 N. Y. Supp. 1059 (1st Dept. 1915), *aff'd,* 217 N. Y. 623, 111 N. E. 1091 (1916).

tion was disregarded entirely as being mere surplusage.[8] Of course, where the valid provisions of a trust depend absolutely upon funds to be illegally accumulated, the whole trust fails.[9]

Out of all these principles and rules of law, a most interesting and ofttimes perplexing problem has arisen. What shall be done with funds which have been illegally accumulated by a trustee? We have seen that in the case of valid accumulations for the benefit of a minor, all the income accumulated during his minority must be for his exclusive benefit. In cases not involving minors, we do not have the benefit of such clear legislative enactment. In England, income which has been unlawfully accumulated passes as in cases of intestacy to the heirs and next of kin of the settlor, if he is dead.[10] This is not the rule in New York.

However, we do have a provision of the *Real Property Law*[11] which declares that in cases where there has been a suspension of the power of alienation or of ownership, "during the continuance of which the rents and profits are *undisposed of,* and *no valid direction for their accumulation is given,* such rents and profits shall belong to the persons *presumptively entitled to the next eventual estate.*" This section applies also to trusts of personal property.[12]

This provision, therefore, sets down the first rule governing the disposition of income of trusts, namely, that whenever income of a trust has not been validly given to some person or legally accumulated as the statutes prescribe, such profits shall go to the persons *presumptively entitled to the next eventual estate.* The "next eventual estate" has been said to be "the estate which is to take effect upon the happening of the event which terminates the accumulation."[13] The words "presumptively entitled" designate the persons who, from the face of the instrument itself, are the holders of the next eventual estate. It does not matter that ultimately, in the course of human events, such persons may not be the *actual* possessors of the next estate.[14] Consequently, it has been held that, where remaindermen of a trust giving income to a life tenant have once qualified to take under the conditions stipulated in the will creating the trust, but have died before the life tenant, their estate has become vested and all undisposed-of income under the trust passes to their heirs, and not to the heirs of the testator as an intestacy.[15]

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[8] *In re* Fenton's Estate, 123 Misc. 658, 206 N. Y. Supp. 210 (1924); Equitable Trust Co. v. Miller, 197 App. Div. 391, 402, 189 N. Y. Supp. 293 (1st Dept. 1921).

[9] Mann-Vynne v. Equitable Trust Co. of N. Y., 201 App. Div. 149, 194 N. Y. Supp. 50 (1st Dept. 1922).

[10] 1 JARMAN, WILLS (5th ed.) 312, cited in U. S. Trust Co. v. Soher, 178 N. Y. 442, at 450, 70 N. E. 970 (1904).

[11] §63.

[12] Matter of Harteau, 204 N. Y. 292, 97 N. E. 726 (1912).

[13] Manice v. Manice, 43 N. Y. 303, 385 (1871).

[14] *Ibid.*

[15] Matter of Ossman v. Van Roemer, 221 N. Y. 381, 117 N. E. 576 (1917).

Whether a particular instrument of trust makes some valid disposition sufficient to take it outside the scope of section 63 is another problem which often arises. Naturally, the intention of the settlor will be the guide of the courts. The difficulty arises, however, in determining what are to be considered sufficient circumstances to create an inference of such intent. Quite recently, the Court of Appeals, in an excellent opinion by Justice Pound, very much clarified the situation.[16] The lower court held that certain undisposed-of income should go to the executor of the settlor and not to the person presumptively entitled to the next eventual estate. It conceded that its decision was not based upon an express declaration of the settlor to that effect, but argued that it was apparent from the surrounding circumstances of the whole case that the settlor had intended such a disposition. The Court of Appeals held otherwise. The learned judge wrote, "A mere inference in the abstract is not enough to supply an obvious omission." [17] And, "We are to search, not for the probable intention of the settlor merely, but for the intention which the trust deed itself, either expressly or by implication, declares." [18] Since the trust deed was silent as to this surplus of income, it was given in accordance with section 63. There are numerous other cases following the statute closely.[19] It seems, too, that under the statute the remaindermen may *immediately* claim all undisposed-of income as it accrues and need not await the death of the beneficiary or the termination of the trust.[20] It has also been held that, where there is no person presumptively entitled to the next eventual estate, an intestacy as to the income will result.[21] The same will follow in cases where the persons so designated by section 63 will not be ascertainable until the happening of some contingency.[22] Nor will the statute apply where there is a residuary devise sufficiently broad and explicit to include undisposed-of income within its scope.[23]

By far, the most intriguing and debatable question in this whole field is the determination of whether, in a particular case, there are undisposed-of profits or income. Perhaps the leading case on the subject is *Matter of Hoyt*.[24] There the testator created a trust for

[16] Central Union Trust Co. v. Trimble, 255 N. Y. 88, 174 N. E. 72 (1930).
[17] *Id.* at 92, 174 N. E. at 73.
[18] *Id.* at 93, 174 N. E. at 73.
[19] Dodge v. Pond, *supra* note 7; Cochrane v. Schell, 140 N. Y. 516, 35 N. E. 971 (1894); Matter of Kohler, 231 N. Y. 353, 132 N. E. 114 (1921); Endress v. Willey, 102 N. Y. Supp. 71 (1906), *aff'd*, 122 App. Div. 110, 106 N. Y. Supp. 726 (4th Dept. 1907), *aff'd*, 197 N. Y. 541, 91 N. E. 1112 (1910).
[20] Endress v. Willey, *supra* note 19.
[21] St. John v. Andrews Institute for Girls and Smithsonian Institution, 191 N. Y. 254, 83 N. E. 981 (1908).
[22] U. S. Trust Co. v. Soher, *supra* note 10.
[23] Matter of Vanderbilt, 229 App. Div. 574, 243 N. Y. Supp. 165 (1st Dept. 1930).
[24] 116 App. Div. 217, 101 N. Y. Supp. 557 (1st Dept. 1906), *aff'd*, 189 N. Y. 511, 81 N. E. 1166 (1907).

the benefit of his daughter, authorizing his trustees to collect the income and expend it for her use for life "in the most bounteous and liberal manner." He also provided that, at her death, the principal and "any surplus of income therefrom, if any, which shall not have been applied to her use during her natural life * * *" should go to certain designated persons. At the death of the daughter, there remained more than $24,000 in the hands of the trustee, which sum represented income which had not been expended. Both the remaindermen and the executor of the life beneficiary claimed the money. The court held that the executor was entitled to the proceeds. It showed that the manifest intent of the testator was to place the entire income at the disposal of his daughter; that a restriction in the will giving the trustees discretion in amount expended with a view of her needs, conveniences and comfort was merely a stipulation as to the method of payment; that the right to the entire income vested in the daughter; and that the devise of surplus incomes to the remaindermen was so inconsistent with the obvious and express intent of the testator that it could not be deemed to have been intended by the testator as voiding the prior provisions of the will or as ever giving to the persons named the right to dispute the propriety of any payments to the beneficiary as an abuse of the discretion of the trustee.

The court then presented another argument. Assuming the provision as to the surplus income to be intended, there was obviously a provision to accumulate such surplus. This was invalid. Section 63 of the Real Property Law would then apply, *providing* there was no valid disposition of the income. But there was such a disposition, if we struck out the one invalid provision (in accordance with the cases cited above). It was within the power of the trustee to use *all* the income for the benefit of the daughter. The daughter being entitled to all the income, it followed that upon her death any unexpended sums must go to her executor.

The reasoning of this case and that of *Matter of Keogh* [25] have been adopted and reiterated time and again ever since.[26] In fact, it began to seem impossible to provide in general terms for the benefit of a life beneficiary without thereby devising the entire income of the trust fund to him or his heirs. In *Hill* v. *Guaranty Trust Co.*[27] the trust was for the use and benefit of the settlor's son, who was a life convict when the will was executed. Soon after the death of the settlor, the son was transferred to the state asylum for insane convicts. Naturally, most of the income was unexpended, and by the

[25] 112 App. Div. 414, 98 N. Y. Supp. 433 (2d Dept. 1906), *aff'd*, 186 N. Y. 544, 79 N. E. 1109 (1906).

[26] Bloodgood v. Lewis, 209 N. Y. 95, 102 N. E. 610 (1913); *In re* Megrue, supra note 7; *In re* Bavier, 164 App. Div. 358, 149 N. Y. Supp. 728 (1st Dept. 1914); Crawford v. Dexter, 178 App. Div. 764, 166 N. Y. Supp. 376 (1st Dept. 1917), *aff'd*, 224 N. Y. 586, 120 N. E. 860 (1918); Curtis v. Curtis, 184 App. Div. 274, 171 N. Y. Supp. 510 (1st Dept. 1918).

[27] 163 App. Div. 374, 148 N. Y. Supp. 601 (1st Dept. 1914).

terms of the will all surplus incomes were to go to the remaindermen. Yet the court held in accordance with the rule stated above.

An even more forceful example appears in the case of *Penniman* v. *Howard.*[28] There, the will provided for the collection of rents by the trustee, the payment of necessary expenses, and the payment of a $2,500 annuity to a niece. Any surplus was to be accumulated for the benefit of the realty. The court held the latter provision invalid and gave *all* the income above expenses to the niece, on the basis of the *Hoyt* case. The court said it was clear that the testator intended the niece to have all the rents, especially in view of a clause which stated that upon a sale of the realty by the trustee, all the proceeds were to be invested in bonds and *all* the income was to go to the niece. The $2,500 stipulation was to be regarded as an attempt by the testator to anticipate the cost of maintaining the realty and the average necessary expense of the niece. This was certainly going pretty far!

Recently, the Court of Appeals handed down a decision in the case of *Chemical Bank & Trust Co.* v. *Streat,*[29] which to some extent upsets the positive stream of cases flowing from the *Hoyt* decision. At least, we may say that, for the first time, it marks a wavering from the strictly-adhered-to rules noted above. A strong dissenting opinion was written by Hubbs, *J.*, and was concurred in by two others.

The situation was as follows: James Streat, eighty years old, established a trust fund for his spinster sister, seventy years of age. The latter had an annual income of about $9,000 from her own property. In March, 1924, she had been stricken with apoplexy and immediately thereafter James established this trust fund of $100,000 for her benefit. Some three months later, he executed a will whereby he also established an annuity of $20,000 per year for her benefit. The will further provided that, upon the death of his sister, all funds of the trust agreement created three months previous to the will should become part of the residuary estate, to go to their brother, Thomas. In December of that year, James died, and, soon after, his sister was declared incompetent and a committee was appointed. This committee found the annual income of $29,000 to be twice as much as was needed for the sister's maintenance. This annual income consisted of that arising from the sister's own property and the $20,000 annuity created by the will. Naturally, the income of the trust fund was never used. Upon the sister's death, this controversy arose as to the ownership of the income which had accrued under the trust. As in previous cases, the money was claimed by both the administrator of the sister's estate and the residuary legatee, Thomas.

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[28] 71 Misc. 598, 128 N. Y. Supp. 910 (1911).

[29] 263 N. Y. 159, 188 N. E. 289 (1933).

The majority opinion, per O'Brien, *J.*, held for the residuary legatee. Its reasoning follows: The trust deed stated that the settlor intended to create a fund for the benefit of his sister "either when her individual income is insufficient for her needs, or when she is unable to obtain prompt payment thereof, whether by reason of her own physical disability, or otherwise." It directed the trustee, the predecessor of the plaintiff, to pay out the income for the maintenance of his sister with the "broadest liberality" whenever her income was insufficient or unavailable. If the income of the trust was insufficient, the principal was to be used. By the terms of the deed, the settlor reserved the right to "receive and retain" all the income collected at any time, and the right of revocation was also provided for. It was clear from these facts, said the court, that no absolute gift of the income was intended by the settlor. As a matter of fact, during his lifetime, he retained and used for himself all the income which accrued. Upon his death, the right of the beneficiary remained conditional—that is, conditioned upon the insufficiency of her own income. Whenever income collected was not needed, it might be immediately claimed by the residuary legatee. So there was no invalid accumulation. Of course, if the legatee desired he might allow the income "to accrue into a reserve to be expended for Bertha in an emergency." [30]

The court then dismissed the *Hoyt, Keogh,* and other cases mentioned above in eight lines, holding that in those cases the courts had declared the settlor's intent to have been clearly a gift of the entire income.

The minority opinion followed the reasoning of the *Hoyt* and subsequent cases. It was clear that the settlor intended to provide for his sister with the "broadest liberality." Even the principal could be used. And it might reasonably be needed. After all, the income of the sister's own property was but $9,000. The committee later showed an expenditure of about $16,000. Also, the settlor conceived the possibility of times when the sister might not be able to collect her income. (There was no committee as yet.) And so, in line with *Matter of Hoyt,* the gift was of *all* the income subject only to the discretion of the trustee and directions of the settlor as to the *manner of payment.* Those conditions were *not* conditions precedent to ownership. Further, the right of the settlor to receive and retain the income was personal and did not pass to the residuary legatee, who by the will was entitled to the "funds" of the trust agreement. It was inconceivable that the settlor could have intended to give the legatee the power to object to specific expenditures by the trustee in any year or to defeat the purpose of the trust by retaining the income for himself. Since an absolute gift of the income was obviously intended, all accrued income should go to the estate of the

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[30] *Id.* at 167, 188 N. E. at 291.

life beneficiary. Such a decision would eradicate any element of unlawful accumulation.

So run the opinions of the court. One who reads them is immediately struck with the powerful arguments on both sides. Where the Court of Appeals has disagreed by a four-to-three decision, there is room for much debate. It seems to us that the majority of the judges, influenced by considerations of justice in the abstract sense, have seized upon this close case to initiate a possible departure from previous well-defined rules of trust construction. While it is true that in all of these cases discussed and noted, the settlor intended to provide bounteously for his beneficiary, it is probably even more true that he rarely desired that any sums left unexpended at the death of the beneficiary should go to the heirs of the beneficiary rather than the remainderman expressly designated by himself. This is clearly manifested by the omnipresent clauses giving principal and any surplus of income to remaindermen. By judicial construction these provisions have been disregarded both as inconsistent with the intent of the settlor where he provides generally for the maintenance of the beneficiary and as violative of the statute against accumulations. It is quite possible that the court does intend to correct this situation. Certainly the vigorous and emphatic dissent more closely accords with established principles of law. What the future may bring is, of course, a matter for conjecture. It does not seem at all probable that the rule of the *Hoyt* case will be obliterated. It is possible that it will be narrowed down. It will be interesting to watch the effect of this decision upon the law of trusts.

MAX MILSTEIN.

MORTGAGES TO SECURE FUTURE ADVANCES.

Mortgages to secure future advances or liabilities are well recognized and fully established. Their validity is no longer open to question.[1] Where a mortgage on its face states that it is to secure future loans to a fixed amount, it is valid only up to that amount,[2] and a collateral oral agreement to extend the mortgage to cover future advances in excess of the limitation on the face of the instru-

[1] Shirras v. Caig, 7 Cranch 34 (U. S. 1812); Leeds v. Cameron, 3 Sumn. 488 (U. S.); Fed. Cas. No. 8206 (1839); Truscott v. King, 6 N. Y. 147 (1852); Robinson v. Williams, 22 N. Y. 380 (1860); Ackerman v. Hunsicker, 85 N. Y. 43, 39 Am. Rep. 621 (1881); Bank of Utica v. Finch, 3 Barb. (N. Y.) c. 293, 49 Am. Dec. 175 (1848); Forsyth v. Preer, 62 Ala. 443 (1878); Hubbard v. Savage, 8 Conn. 215 (1830); Straeffer v. Rodman, 146 Ky. 1, 141 S. W. 742 (1913); Newkirk v. Newkirk, 56 Mich. 525, 23 N. W. 206 (1885).

[2] Mowry v. Sanborn, 68 N. Y. 153 (1877); Ford v. Davis, 168 Mass. 116, 46 N. E. 435 (1897).