CALCULATING THE DISTRIBUTION OF A STOCK
DIVIDEND BETWEEN LIFE TENANT
AND CORPUS

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Much uncertainty and confusion exists among the members of the bar and trust officers in regard to the ascertainment of the amount to which a life tenant is entitled when a corporation has declared a stock dividend. The writer believes that the existing uncertainty and confusion has been caused chiefly by the mathematical calculations as prescribed by the Supreme Court. The purpose of this article is to make an analysis of these calculations and to state certain general conclusions that can be drawn therefrom.

As the subject of this paper is the calculations by which the rule is applied rather than the rule itself, we will not discuss the decisions by which the rule was formulated and its application gradually extended. But we will start with a short quotation from the leading case in which the rule was first stated.

In *Earp's Appeal* the Supreme Court said:

"The distribution of it [the corporate surplus] among the stockholders in the form of new certificates has no effect whatever upon the equitable right to it. It makes no kind of difference whether this fund is secured by 540 or 1350 certificates. Its character cannot be changed by the evidence given to secure it. Part of it is principal—the rest is 'income,' within the meaning of the will. The principal must remain unimpaired during the lives of the appellants [the life tenants] and the 'income' arising since the death of the testator is to be distributed among them."  

This is generally known as the American rule and has been adopted in most of the states. It seems to be generally conceded that the rule is theoretically correct in its attempt to give the life

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1 All references to the Supreme Court are to the Pennsylvania Supreme Court.
2 28 Pa. 368, 374 (1857).
tenant the income and only the income. But the difficulty of applying the Pennsylvania rule has influenced many to prefer the Massachusetts rule, which is frankly a rule of convenience and gives cash dividends to the life tenant and stock dividends to the corpus. This paper is an effort to justify a theoretically correct rule of law, by a practical discussion of the method of its application, in the hope of removing some of the uncertainty and confusion which we believe everyone feels when first studying the mathematical calculations by which the rule has been applied in the past.

The rule has been applied to an extraordinary cash dividend, to a stock dividend and to dividends in voluntary liquidation. In *Nirdlinger's Estate*, the Supreme Court extended the rule to a case where a trustee has realized a profit by selling the stock held by the trust, the court holding that in such a case the life tenant was entitled to so much of the profits as represented the income or earnings of the corporation since the acquisition of the stock. It has also been stated by the Supreme Court that the rule applies to the case of rights to subscribe.

The Supreme Court has many times said that the rule is based on an effort to give the income to the life tenant as directed by the will and that the question is one of applying equities as between life tenant and remainderman. While the directors of a corporation have reasonable discretion in determining what portion of the surplus will be distributed to the stockholders by the regular dividends, their action in withholding a portion of the income or earnings from distribution cannot affect the relative rights of life tenant and remainderman to such surplus income or earnings. In equity the life tenant is the real owner of the income or earnings and the remainderman is the real owner of the principal of the fund. When there has been any distribution of the assets of the corporation to stockholders (other than by a regular dividend to which the rule does not apply at all), whether by action of the directors or by action of the trustee in selling the stock, the apportionment between life

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tenant and corpus does not depend upon the manner in which the directors have used the surplus income or earnings prior to its liquidation, nor upon accounting methods, nor upon the name that the directors have given to the excess earnings or income, nor upon the form that the directors have used in declaring the extraordinary dividend. The apportionment depends solely on the equities between life tenant and remainderman resulting from the testator's direction that the income should be given to the life tenant.

So much for the rule itself, as so enunciated by the Supreme Court and generally accepted as theoretically reasonable. It is in the application of the rule and in the performance of the mathematical calculations that difficulty and confusion arise.

Prior to 1926 when *Dickinson's Estate* was decided, the rule was applied to the case of a stock dividend in the following manner. The value of the trustee's holdings when the stock was acquired is first ascertained and then the value of the original shares immediately after the declaration of the stock dividend. If the latter figure is less than the former, a sufficient amount from the stock dividend is awarded to the corpus, which, when added to the value of the original shares immediately after the declaration of the stock dividend will equal the value of the shares when they were acquired. The rest of the stock dividend is awarded to the life tenant.

*Dickinson's Estate* introduced another factor into the calculations. It involved a stock dividend of the Fire Association of Philadelphia. The evidence showed that the book value of the trustee's holdings at the time of their acquisition was less than their book value after the distribution of the stock dividend, so that under the application of the rule which we have just described, the whole stock dividend would have been awarded to the life tenant. But there was also evidence of two transactions which was held to necessitate a change in the application of the rule. First, the San Francisco fire occurred during the period and the resulting loss caused a large decrease in the book value

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4 *285 Pa. 449, 132 Atl. 352 (1926).*
of the assets. Secondly, the Fire Association sold two blocks of new stock, realizing considerably more than the par value of the stock sold, which resulted in a large increase in the assets and added $112.50 to the book value of each of the trustee's shares. The court held that both of these were principal transactions as between life tenant and remainderman; and that the fire loss must be deducted from and the gain on the sale of the stock must be added to the intrinsic value of the trustee's stock at the time of its acquisition, in order to ascertain the intact value that must be preserved for the remainderman. When this was done the calculations proceeded as in the previous cases.\(^5\)

The principle decided in Dickinson's Estate was reaffirmed in Packer's Estate,\(^6\) and the method of calculation was thus restated:

"In making it [the distribution of the stock dividend], there should always be awarded to the corpus of the trust such a number of the shares included in the dividend as, with the shares upon which the dividend was declared, at the actual or intact value of the two after the stock dividend is declared and paid, will aggregate exactly the same sum as the actual or intact value of the original shares at the time the trust acquired them, plus any capital increase thereafter paid to the corporation on account of those shares, and less a proportionate part of any capital losses properly chargeable against them."\(^7\)

It has been held that this method of application of the rule applies to extraordinary cash dividends, to rights to subscribe and to dividends in liquidation, as well as to stock dividends.

An entirely different method of calculation was laid down in Nirdlinger's Estate to apply the rule to the apportionment be-

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\(^5\) The method in which the Supreme Court charged the San Francisco fire loss against the corpus of the estate, so that it should not be charged against the income or earnings during the life tenancy, was criticized in the dissenting opinion of Mr. Justice Kephart. See Note (1925) 74 U. of Pa. L. Rev. 618. Whether or not the dissenting opinion would lead to more accurate results, the general principle decided by this branch of Dickinson's Estate is undoubtedly as we have stated it above.

\(^6\) 291 Pa. 194, 139 Atl. 867 (1927).

\(^7\) Supra note 6, at 197, 139 Atl. at 867.
tween life tenant and remainderman of the profit realized by the trustee by the sale of the stock:

"From what we have said, it follows that where the trustee sells stock which represents in part accumulated earnings sufficiently earmarked that they can be ascertained, the life tenants are entitled to an apportionment of these earnings, not in any manner reducing the intact value of the corpus." 8

We therefore have two distinct and apparently different methods of calculation by which we must apply the Pennsylvania rule to the two different situations. The purpose of this paper is to analyze these two methods of calculation for the purpose of ascertaining whether either of them can be simplified, whether both of them can be reduced to a single formula and whether any helpful general conclusions can be formed. We will start with the calculations applicable to a stock dividend.

The first factor to be analyzed is the value of the assets of the corporation. In Earp's Appeal 9 the only evidence of value was the market value of the stock at the date of the acquisition of the stock and the market value of the stock after the declaration of the stock dividend. The Supreme Court has recently, quite properly we think, discarded market value as a factor, 10 and we can dismiss such a value.

We are left with book value and intrinsic value. The Supreme Court has many times said that the intrinsic value of the assets is the real figure that should be used for the purposes of the calculation and they have thus left it open for life tenant or remainderman in the future to investigate and prove particular cases where the intrinsic value of the assets differs from the book value. But as far as the practical application of the rule is concerned, we have found no case where the properly proved book value of the assets was rejected by the Supreme Court. On the contrary, an examination of the record in all the recent Su-

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8 Supra note 3, at 475, 139 Atl. at 207.
9 Supra note 2.
10 Packer's Estate, supra note 6, at 197, 139 Atl. at 867; Jones v. Integrity Trust Co., 292 Pa. 149, 155, 140 Atl. 852, 864 (1928).
preme Court decisions on extraordinary dividends shows that in each case the book value was the only value of which there was any evidence. We can, therefore, assume that the book value of the assets is prima facie evidence of their intrinsic value, and we can analyze the calculations on the basis of book value.

The book value of the assets of a corporation is obtained from its balance sheet, which is formed by assembling the balances in all of the primary accounts of the corporation.

On the debit or asset side are the assets of the corporation at their respective book values.

On the credit or liabilities side there are the following:

1. The liabilities of the corporation.
2. The balance of the capital stock account. This is always the par value of the outstanding stock. When new stock is issued, its par value is credited to this account. When old stock is retired, its par value is debited to this account. If new stock is issued for more than par, the par value is credited to this account and the excess over par is credited to the surplus account. The amount received for the stock whether cash or assets of other kinds is credited to the proper asset account, thereby increasing the debit or asset side of the balance sheet by exactly the same amount that the credit or liabilities side has been increased. In the ordinary case that we are considering, that is, where there have been no new issues of stock or no retirement of stock between the time of the acquisition of the stock and the declaration of the dividend in question, the capital stock account remains unchanged during the period. When the stock dividend is issued the par value of the stock is credited to the capital stock account and charged to the surplus account, no change having been made in the assets of the corporation.
3. The surplus account. This may be called the profit and loss account or by some other name. It may consist of two or more accounts, and in such case, by surplus account we mean a

24 Placcus's Estate, 283 Pa. 185, 129 Atl. 74 (1925); Harkness's Estate, 283 Pa. 454, 129 Atl. 458 (1925); Mallory's Estate, 285 Pa. 186, 131 Atl. 714 (1926); Dickinson's Estate, supra note 4; Packer's Estate, supra note 6; Jones v. Integrity Trust Co., supra note 10.
consolidation of the several accounts in which the surplus is accounted for.

From the balance sheet, it is clear that the net assets of the corporation (i.e., the assets less the liabilities) always equal the par value of the outstanding capital stock plus the balance in the surplus account.

From this fact it follows that if a transaction involving the assets of the corporation or its liabilities or both does not result in changing the book value of the net assets, no change is made in the surplus account. On the other hand any transaction which increases or decreases the net assets must necessarily increase or decrease the surplus account. Whenever there has been an increase or a decrease in the net assets there must be a contemporaneous credit or charge in the surplus account, and conversely whenever there is a credit or charge in the surplus account there must be a corresponding increase or decrease in the net assets. In all properly kept books, each entry in the surplus account indicates the source of the increase or decrease in the net assets or refers to a subsidiary account giving this information. Therefore the surplus account for any period gives a complete account of all the increases and decreases in the assets during that period.

In addition to the balance sheet accounts, the corporation generally keeps a separate set of operating accounts which are periodically closed into surplus account.

The book value of the assets of the corporation at the acquisition of the stock is therefore obtained by preparing a balance sheet as of that day and by adding, to the par value of the outstanding capital stock, the balance then standing in the surplus account.

We have shown that the surplus account contains an appropriate entry for every increase or decrease in the book value of the assets of the corporation. If, therefore, we have the surplus account from the acquisition of the stock to the declaration of the dividend, we can ascertain the book value of the assets of the corporation on the latter date by adding, to the book value of the

\[ \text{We are now disregarding issuance of new stock or retirement of old stocks, which present entirely different accounting situations.} \]
assets at the acquisition of the stock, the total increase in the book value as shown by the surplus account.

We next come to the amounts which must be added to or subtracted from the value of the assets at the time of the acquisition of the stock, in order to determine the value that must be preserved for the remainderman, under the formula as stated in Dickinson's Estate and Packer's Estate. The $112.50 per share that was added in Dickinson's Estate was added because it "was not income which had accrued on the stock"; and because:

"In no sense could these sums have been considered income; they were rather profits on the capital investment, which always belong to capital." 14

The San Francisco fire loss was subtracted, because when the testator gave to the life tenants:

"... all the income earned after his, testator's death, he meant just what he said, and hence that gift cannot properly be cut down, for the benefit of the remainderman, because the corporation was compelled, in order to meet an extraordinary loss, to use a portion of the surplus which had been accumulated before testator's death." 15

In this paper we are not directly concerned with the principles upon which the court will determine whether, as between life tenant and remainderman, a particular item in the surplus account is a principal gain or loss or whether it is income or earnings. But under Dickinson's Estate this question must be decided by the court whenever it is raised as to any item by life tenant or remainderman. And to make a complete application of the decision in Dickinson's Estate, we must classify all the entries in the surplus account and segregate those which are principal accretions or losses from those which are credits to or charges against income or earnings.

Having done this we find that the book value of the assets of the corporation at the time of the declaration of the stock divi-

12 Supra note 4, at 453, 132 Atl. at 333.
13 Supra note 4, at 455, 132 Atl. at 354.
14 Supra note 4, at 452, 132 Atl. at 333.
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dividend will be the book value at the time of the acquisition of the stock, plus the capital accretions (or minus capital losses, as the case may be), plus the income or earnings, in excess of the regular dividends paid, during the period.

With this analysis of the various factors involved in the calculation necessary to ascertain what portion of the stock dividend the life tenant is entitled to, we are ready to analyze the formula itself. We will state the formula in algebraic form and then resolve it into its simplest terms.

Let $a =$ the number of shares originally acquired by the trustee.

$b =$ the number of shares of the corporation outstanding at the time the stock was acquired.

c = the number of shares in the whole stock dividend.

d = the intrinsic value of the assets of the corporation at the time the stock was acquired.

e = the total capital accretions from the time the stock was acquired to the declaration of the stock dividend, i.e., the total that must be added to the intrinsic value at the time the stock was acquired to determine the intact value that must be preserved for the remainderman.

$f =$ the total income or earnings, in excess of the regular dividends paid, during the same period.

The intact value of each share of the trust which must be preserved for the remainderman $= \frac{d+e}{b}$ (I).

The intrinsic value of the assets of the corporation at the declaration of the stock dividend $= d+e+f$.

The intrinsic value of each share after the declaration of the stock dividend $= \frac{d+e+f}{b+c}$ (II).

The amount that must be awarded to the corpus for each share of trust in order to preserve the intact value for the remainderman $= (I) - (II) = \frac{d+e}{b} - \frac{d+e+f}{b+c}$.
The amount that must be awarded to the corpus for its total holdings \(= a \left( \frac{d+e}{b} - \frac{d+e+f}{b+c} \right) \) (III).

The number of shares of new stock received by the trustee \(= \frac{ac}{b} \) (IV).

The intrinsic value of the whole stock dividend received by the trustee \(= (IV) \times (II) = \frac{ac}{b} \left( \frac{d+e+f}{b+c} \right) \) (V).

The amount that must be awarded to the life tenant \(= (V) - (III) = \frac{ac}{b} \left( \frac{d+e+f}{b+c} \right) - a \left( \frac{d+e}{b} - \frac{d+e+f}{b+c} \right) \).

This formula is resolved into its simplest terms as follows:

\[
\frac{ac}{b} \left( \frac{d+e+f}{b+c} \right) - a \left( \frac{d+e}{b} - \frac{d+e+f}{b+c} \right) =
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a \left[ \frac{c}{b} \left( \frac{d+e+f}{b+c} \right) - \frac{d+e}{b} + \frac{d+e+f}{b+c} \right] =
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a \left[ \frac{cf+bf}{b(b+c)} \right] = a \left[ \frac{f(b+c)}{b(b+c)} \right] = a\frac{f}{b}.
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This simplified formula, \(a\frac{f}{b}\), is the total income or earnings, in excess of the regular dividends paid, during the period, divided by the number of shares of the corporation outstanding at the time the stock was acquired, multiplied by the number of shares originally held by the trustee. Whenever we have before us the complete surplus account from the date of the acquisition of the stock to the date of the declaration of the stock dividend we can ascertain the amount to which the life tenant is entitled by this simple formula, and we have mathematically demonstrated that this formula will reach exactly the same result as if we had
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followed the elaborate calculations prescribed by Dickinson's Estate and Packer's Estate.

In the case of an extraordinary cash dividend or of rights to subscribe, the formula for the amount to be distributed to the life tenant can be stated in the same manner that we have stated the formula for a stock dividend; and when these two formulas are reduced to their simplest terms, we will in each case reach the same result that we have reached in the case of a stock dividend; namely, that the amount to which the life tenant is entitled will be \( a \frac{f}{b} \).

We now come to the case in which a trustee has realized a profit by the sale of the stock, and we find that the calculation by which we determine the amount to which the life tenant is entitled is thus stated in Nirdlinger's Estate:

"From what we have said, it follows that where the trustee sells stock which represents in part accumulated earnings sufficiently earmarked that they can be ascertained, the life tenants are entitled to an apportionment of these earnings, not in any manner reducing the intact value of the corpus." 16

In other words the calculation is precisely the same as the short cut that we have arrived at for extraordinary dividends; namely, \( a \frac{f}{b} \).

We have now reached a uniform method of calculating the amount to which the life tenant is entitled, applicable to any of the methods of distribution of corporate surplus which have been before the courts. And we find that by this method of calculation we are simply proceeding directly to the ascertainment of the fundamental fact which lies at the basis of the Pennsylvania rule and which is thus concisely stated in the opinion in Earp's Appeal:

"Part of it [the corporate surplus] is principal—the rest is 'income', within the meaning of the will." 17

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16 Supra note 3, at 475, 139 Atl. at 207.
17 Supra note 2, at 374.
Are there any general conclusions that can be drawn from this analysis and then tested as to their general reasonableness?

In the first place the same formula determines the amount to which the life tenant is entitled, whether the distribution of assets has been by the declaration of an extraordinary dividend or by the sale of the stock by the trustee. This certainly seems correct, as the Supreme Court has held that it is the same rule that applies to both cases. Also it would be unreasonable to apply a different formula to these two situations because the amount that the life tenant should receive depends on how much income or earnings the corporation had made and not upon the action of the trustee.

In the second place this formula gives to the life tenant the same amount whether the directors have declared an extraordinary cash dividend, or a stock dividend, or have issued rights to subscribe, and irrespective of the amount of the cash dividend, or the number of shares in the stock dividend, or the number of shares to which the stockholder is given the right to subscribe (subject, of course, to the qualification that is present in all these cases; namely, that the life tenant in no event can receive more than the whole dividend). That this is a reasonable result to reach is evident.

In the third place if the amount to which the life tenant is entitled can be ascertained by inserting the appropriate figures in the formula \( \frac{a^f}{b} \), then the book value of the assets at the time of the acquisition of the stock need not be used at all in the calculations. It has no effect on the amount to which the life tenant is entitled. The same thing applies to the book value of the assets at the time of the declaration of the extraordinary dividend.

Let us see whether the intrinsic value of the assets (where it differs from the book value) is equally immaterial. If it appears in a particular case that some asset, which the corporation owned at the time of the acquisition of the stock, was carried at a book value less than its intrinsic value, and there was no change in the intrinsic value of that asset during the period in question, it is evident that no change would be made in the amount
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This statement could be tested out and proved if space permitted. On the other hand, if the intrinsic value of a principal asset increases during the period in question, it immediately becomes necessary under Dickinson's Estate, and under the method of calculation laid down in Packer's Estate, for the court to determine whether this increase is a capital accretion or is income or earnings. We have no doubt whatever that the Supreme Court would decide that this was a principal gain and not income or earnings as between life tenant and remainderman. If such an increase is a capital accretion, it will be included in e in the working out of the formula; if it is income or earnings, it will be included in f. But whichever way the court decides this question, the formula \( \frac{a_f}{b} \) will give to the life tenant exactly the same amount as he would receive under the formula in Packer's Estate. These statements can also easily be checked up and their accuracy shown.

Therefore by calculating the amount to which the life tenant is entitled by the formula \( \frac{a_f}{b} \), we find it entirely unnecessary to use either the book value or the intrinsic value of the assets of the corporation, either at the time of the acquisition of the stock or at the time of the declaration of the extraordinary dividend or the sale of the stock. This seems to be entirely reasonable, judging by the considerations which in the ordinary case of trust management determine the question as to whether a particular amount is principal or income. The value of the principal of the trust fund (whether market value, book value, or intrinsic value) has no direct bearing on the question as to whether a particular item of receipt or expense should be considered as income or principal.

It therefore appears that not only have we evolved a simple formula and one uniformly applicable to all the situations under discussion, but we have shown that judging the rule from its real foundation there is reasonable ground for the exclusion of every factor used in the formula in Packer's Estate, except those di-
rectly necessary to ascertain the life tenant's share in the income or earnings of the corporation during the period.

The use of this formula will immediately eliminate most of the mathematical difficulties of applying the rule. Nothing but purely legal questions will be left for lawyers to advise upon and courts to decide. Having before us the surplus account from the time of the acquisition of the stock to the time of the declaration of the extraordinary dividend or the sale of the stock, most of the items therein will easily classify themselves as principal or as income. Any doubtful items will be classified upon the same principles that the Supreme Court applied in Dickinson's Estate and in Nirdlinger's Estate and which the courts must necessarily apply even under the method of calculation prescribed by Packer's Estate, whenever the particular item becomes a subject of dispute between life tenant and remainderman.

The question will immediately arise in the mind of the reader of this paper: Why has not the Supreme Court adopted this simple formula. The answer is plain. The formula can only be used when the court has before it a complete surplus account from the time of the acquisition of the stock to the time of the declaration of the extraordinary dividend or the sale of the stock. And this evidence has never been present in any case decided by the Supreme Court. Lawyers in preparing stock dividend cases have never presented all the facts to the court. They have been satisfied with proof of the book value of the assets at the time of the acquisition of the stock and the book value of the assets at the declaration of the stock dividend. With this incomplete evidence it has been necessary for the court to apply a presumption. It has therefore been held that in the case of the stock dividend the presumption favors the life tenant, and the life tenant receives all the dividend except so much thereof as the remainderman has proved belongs to the corpus. As the court has had nothing before it but the book values at the beginning and at the end of the period, it is clear that the remainderman has not proved that he is entitled to more than the preservation of the intrinsic value of the stock at the time of its acquisition. The complicated and confusing calculations prescribed in Pack-
er's Estate have therefore resulted from the fact that each lawyer representing a remainderman has confined himself to introducing the same evidence that was introduced in the preceding cases. The Supreme Court has never been given the full information which would have enabled them to apply the appropriate equities between life tenant and remainderman without these elaborate calculations.

In Nirdlinger's Estate, when the Pennsylvania rule was first extended to a sale of the stock by the trustee, the Supreme Court did exactly the same thing which we are here contending should be done in the case of the distribution of a stock dividend. They held that the life tenant must earmark the income or earnings of the corporation during the period, and he would then be given, out of the profit realized from the sale of the stock, his proportionate share of those earnings.

In view of the decision in Dickinson's Estate, any careful lawyer representing a remainderman must be sure that he has ascertained every item of increase in the assets which should be added to the intrinsic value of the stock at the time of its acquisition, in order to determine the intact value that must be preserved for the remainderman. The book values at the time of the acquisition of the stock and at the time of the declaration of the stock dividends do not give him this information. He can only be sure of this by an inspection of the surplus account, and when he has picked out of the surplus account all the items which are principal accretions or losses, all the items left in the surplus account will constitute income or earnings. The attorney for the remainderman will then know that the life tenant is entitled to his proportionate share of the income or earnings and that the remainderman will get the balance of the stock dividend.

In studying the decisions it has seemed clear to the writer that, just as soon as the Supreme Court has before it a case including the full surplus account from the date of the acquisition of the stock to the date of the declaration of the extraordinary dividend or of the sale of the stock, they will find it unnecessary to apply a presumption favoring either the life tenant or the remainderman or to go through the elaborate calculations
prescribed in Packer's Estate. They will proceed directly to the
determination of the question: How much of the increase in
the assets of the corporation came from principal transactions
and how much was income or earnings.

We have shown that \( \frac{a}{b} \) gives the amount to which the
life tenant is entitled under any method of liquidation of sur-
plus. If the liquidation has taken the form of an extraordinary
cash dividend or has been brought about by the sale of the stock,
the trustee has cash in his hands, and the formula shows the
amount of cash to which the life tenant is entitled. When the
liquidation has taken the form of a stock dividend, the trustee
has stock in his hands instead of cash, and the question then
arises as to how much of the stock should be given to the life
tenant to represent the amount to which he is entitled.

It would seem that this question should be decided in the
same manner as in any situation where it becomes necessary to
determine how many shares of stock are equivalent to a certain
amount of cash, and that the amount to which the life tenant is
entitled should be divided by the market value of one share of
stock at the time of the declaration of the stock dividend, to as-
certain the number of shares that should be transferred to the
life tenant.

We are not aware of any case in which this matter has been
discussed by the Supreme Court, but the court seems to have de-
cided that the amount to which the life tenant is entitled should
be divided by the book value of the stock rather than by the mar-
ket value. We submit that this cannot be logically justified.

The reason for the Pennsylvania rule is that since the testa-
tor has given the income to the life tenant, he is the equitable
owner of the income or earnings of the corporation during the
life tenancy, even though the corporation has withheld the dis-
tribution of them. As the income is earned by the corporation
in the form of cash, the amount to which the life tenant is entitled
should be figured in cash, and he should be paid in cash or in
something the equivalent of the cash to which he is entitled. To
pay him in stock at its book value, is to establish a rule of law
which is directly contrary to practical experience and which makes the value he is to receive depend on the vagaries of the stock market. To pay him in stock at its market value, gives him something that he can immediately convert into the amount of cash to which he is entitled.

If, in the case of a stock dividend, the amount to which the life tenant is entitled is given him in stock at its book value, we immediately reach an entirely different result from that reached in the case of an extraordinary cash dividend or a sale of stock by the trustee. On December 31, 1928, the book value of Radio common was $28.32 according to the Standard Corporation Records and its market value was $375, or thirteen times its book value. If a stock dividend had been declared on that date and the amount to which a life tenant was entitled had been distributed in stock at its book value, the life tenant would have received thirteen times as much as the income or earnings of the corporation during the time the trustee held the stock, and thirteen times as much as the life tenant would have received if the corporation had declared an extraordinary cash dividend. If the trustee, anticipating a stock dividend, had sold the stock, he would thereby have caused the life tenant to receive one-thirteenth as much as if he had waited and received the new stock and distributed to the life tenant at book value.

The market value of Radio common increased from $288 to $375 between November 16th and December 31st—an increase of thirty per cent. If a stock dividend had been declared on December 31st and the stock was distributed to the life tenant at its book value, the life tenant would have received thirty per cent. more than if the dividend had been declared on November 16th and distributed in the same manner. The absurdities of these results of paying to the life tenant the income to which he is entitled in stock at its book value is evident.

When the Supreme Court rejected market value in favor of book value they were dealing with figures to be used for the purpose of comparing the assets of the corporation at the time of the acquisition of the stock, with the assets at the time of the declaration of the extraordinary dividend; they were engaged in
ascertaining how much the assets had increased during the life tenancy. It will be seen immediately that the preference for book value as against market value for such a purpose is based upon a real reason. On the other hand, when the court has definitely ascertained the amount of income or earnings of the corporation between the time of the acquisition of the stock and the time of the declaration of the extraordinary dividend, and it is necessary to ascertain how the life tenant’s share in this income should be given to him, an entirely different question is presented.

When the Supreme Court has before it a stock dividend case with the full surplus account of the corporation in the record, we feel confident that, after ascertaining the life tenant’s share of the income earned during the life tenancy, they will distribute the stock to him at its market value. But, however this question is decided, it does not affect the principles upon which the court should determine the life tenant’s share of the income earned during the life tenancy.

In Graham’s Estate,18 recently before the Supreme Court, there were two succeeding life tenants and the stock dividend was declared during the second life tenancy. The court below awarded the whole stock dividend to the second life tenant on the ground that there could be no apportionment between successive life tenants. The executors of the first life tenant took the appeal. The Supreme Court refused to decide the main question, holding that there was a presumption that the whole stock dividend belonged to the life tenant at the time of its declaration and that the executors of the first life tenant had failed to overcome this presumption. Mr. Justice Kephart said in the opinion:

“... but there is no evidence to show earnings to the first life tenant’s death, and the value for each share at that time is not stated. It was thus found by the court below: ‘it does not appear whether any of these undivided profits were earned in the lifetime of the first beneficiary.’ The stipulation of facts throws no light on the question, and we cannot reason it from the trial balance submitted. The gain

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in surplus does not always represent earnings, as that term is understood, nor does its mere presentation throw the burden on the accountant to explain the several items that make it up. It may not be attributable solely to the natural earnings of the stock, but it may in part represent other items of increase not attributable to stock earnings; it may, indeed, state enhanced or present-day value of bonds purchased. From this same surplus is properly deductible losses on account of bad loans or other investments accruing during the period of the first life-tenancy. Surplus often becomes in part a matter of bookkeeping, sometimes altogether. There may be cases where better evidence is not available or through other circumstances it may be used to establish a fact, but we are here considering the division of a testator’s property, where the desired course of distribution is in opposition to a legal presumption. We have no evidence of earnings, and before the principal question may be considered we may be met with another question which need not now be discussed. As it is, any decision on the main point presented by appellant will not be discussed.”

From this quotation from the opinion it appears that the case was decided upon the failure of the executors of the first life tenant to prove what portion, if any, of the total increase in the surplus represented income or earnings during the first life tenancy. It is clear that the Supreme Court had in mind the necessity on the part of the first life tenant of proving the complete surplus account during the period involved. This case, therefore, appears to lend additional authority to the principles which we have discussed in this article.