

Proposed revised Oregon probate code  
ALLOCATION OF INCOME  
1st Draft  
April 3, 1967

Section 1. Unless the will of the decedent otherwise provides, income from the assets of the estate of a decedent received after the death of the decedent and before final distribution, including income from property used to discharge liabilities, claims, debts, expenses of administration and inheritance and estate taxes, shall be determined in accordance with the rules applicable to a trustee under this Act and distributed as follows:

(1) To specific legatees and devisees the income received from the property bequeathed or devised to them respectively, less taxes, ordinary repairs and other expenses incurred in the management and operation of the property, any interest paid during the period of administration on account of such property, and an appropriate portion of taxes imposed on income (excluding taxes on capital gains) which are paid during the period of administration.

(2) To all other legatees and devisees, except legatees of pecuniary bequests not in trust which do not qualify for the marital deduction provided for in Section 2056 of the Federal Internal Revenue Code, as of January 1, 1969 the remaining income, in proportion to the respective interests of such legatees and devisees in the assets of the estate

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which have not been distributed to them or expended for the payment of inheritance or estate taxes, charged against their particular share of the estate, computed at the time of each such distribution or payment, on the basis of inventory values. As used in this subparagraph, remaining income means the total income from all property which is not specifically bequeathed or devised less the taxes, ordinary repairs, and other expenses incurred in the management and operation of all such property from which the estate is entitled to income, any interest paid during the period of administration on account of such property and the taxes imposed on income (excluding taxes on capital gains) which are paid during the period of administration, and which are not charged against the property specifically bequeathed or devised.

(3) Income received by a trustee under this section shall be treated as income of the trust.

References: Advisory Committee Minutes:  
10/14, 15/66 p. 6 et. seq.  
11/18, 19/66 pp. 9 to 12  
2/17, 18/66 pp. 1 to 3  
ORS chapter 129

Proposed revised Oregon probate code  
ALLOCATION OF INCOME  
3rd Draft  
March 21, 1968

Prepared by  
Stanton W. Allison

Section 1. Unless the will of the decedent otherwise provides, income from the assets of the estate of a testate decedent received after the death of the decedent and before final distribution, including income realized from property which is sold or otherwise expended for the purpose of discharging liabilities, claims, debts, expenses of administration and inheritance and estate taxes, shall be determined in accordance with the rules applicable to a trustee under ORS 129.010 to 129.140 and distributed as follows:

(1) To specific devisees the income received from the property devised to them respectively, less the taxes, ordinary repairs and other expenses incurred in the management and operation of the property, any interest paid during the period of administration on account of such property, and an appropriate portion of taxes imposed on income (excluding taxes on capital gains) which are paid from the estate during the period of administration.

(2) To all other devisees (except devisees of pecuniary devises which (A) are not in trust, and (B) do not qualify for the marital deduction provided for in Section 2056 of the Federal Internal Revenue Code) the remaining income, in proportion to their respective interests in the assets of the estate which have not been distributed to them or expended for the payment of inheritance or estate taxes charged against their particular

share of the estate, computed at the time of each such distribution or payment on the basis of inventory values. As used in this subparagraph, remaining income means the total income from all property which is not specifically devised, less the taxes, ordinary repairs, and other expenses incurred in the management and operation of all such property from which the estate is entitled to income, any interest paid during the period of administration on account of such property, and the taxes imposed on income (excluding taxes on capital gains) which are paid from the estate during the period of administration, and which are not charged against the property specifically devised.

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#### COMMENTS

Attached as an addendum are portions of Mr. Jack McMurchie's comments on the problems covered by the proposed chapter.

The Supreme Court has stated that the Uniform Principal and Income Act (ORS 129.010 to 129.140) does not apply to estates. (In re Feehely's Estate, 179 Or. 250, 260, 170 P2d 757.) The first question before the committees, therefore, was whether to amend the Oregon Uniform Act to include the later revisions commented on by Mr. McMurchie and incorporate them by reference in this code, or to include the revisions and basic matters in the probate code. In preparing this code they have consistently avoided incorporating by reference matters they felt belonged in the code. The inconvenience and technical interpretation problems involved in the usual incorporation by reference has ruled out this approach in other cases, and the committees considered that the same considerations should apply here.

The proposed chapter limits its application to income received after decedent's death and before final distribution.

It also limits its application to testate estates. It was felt that there were no pressing problems in intestate situations since the residue is divided and the income allocated in the same way. The chapter would have no application if the will provides for income allocation different from that set out here.

Section 1 refers to the Uniform Act as codified in Oregon statutes, for the definitions of income and principal. However, income received from assets sold or expended during probate for payment of administration expenses, claims and taxes is treated as income, even though the expended assets would not become part of the residue. As noted by Mr. McMurchie, this is contrary to In re Feehely's Estate (supra).

Subsection (1) provides that the net income received from specifically devised property is distributed to the specific devisee.

Subsection (2) covers general devises. It includes the periodic adjustment rule as proposed by the later revision of the Uniform Principal and Income Act. It does also, however, provide that spouses receiving pecuniary bequests which qualify under the marital deduction provisions of the Internal Revenue Code share in the income in the same way as a residuary devisee. It was the intent of the committees that this chapter be so drafted that periodic adjustments would not be required on payment of ordinary claims or administration expenses but only where payment of estate and inheritance taxes or substantial claims should require an equitable apportionment. In the interest of simplicity the apportionment when required would be on the basis of inventory values.

The proposed chapter has been discussed with trust officers of banking institutions and with others who deal with problems

of allocations of income in estates, and your committees believe the proposal represents the consensus of experts in this field.

ADDENDUM

(Excerpts from Mr. McMurchie's appearance before the joint committees.)

"The Oregon Supreme Court has spoken very little on this subject. ...the court has held that the Uniform Principal and Income Act does not apply to estates, and as a result we have the situation now that pretty much whatever is brought before the court as a suggested method of allocating income earned during administration is adopted and approved by the court in the final account if the matter is even raised in the final account."

"Everything I say is 'the general rule' or 'the Restatement of Trusts' rule and is not necessarily the rule in Oregon.

"The recipient of a specific devise or bequest or a bequest of an annuity is entitled to the income earned by the property bequeathed during the period of administration. This assumes, of course, that you have a residue out of which you can pay expenses of administration and taxes.

"The next category is a general legacy. A general legacy is usually pecuniary in nature. You may have a general legacy which is in the nature of a specific legacy such as a gift of a number of shares of stock which you don't own at the time of your death. However, even then the legacy would be in the nature of a pecuniary legacy during the period of administration. For one reason or another, the rule has grown up over the years that an outright pecuniary bequest is not entitled to share in the income earned during administration except in the event that the legacy is not satisfied within the 'common law period of administration,' whatever that is in Oregon. There is some feeling that if you have not satisfied a pecuniary legacy within one year after the date of death, the legatee is entitled to interest at the going rate on the bequest from that date until such time as it is paid. This is consistent with the common law except we don't know what the common law period of administration is in Oregon."

(The proposed code provides for paying 3 percent interest on general pecuniary devises after one year from the appointment of the personal representative, unless the will provides otherwise.)

"Contrary to the situation where an outright pecuniary legacy is entitled to no income, courts have generally held that a pecuniary legacy in trust is entitled to participate in the income earned during the period of administration. The amount of the income is another problem, but the general rule is that it is entitled to its proportionate share of the income. The question is whether you must make periodic adjustments in the ratio of the fixed value bequest to the entire estate -- whether you must make periodic adjustments so that the general legacy in trust actually gets a proportionate share of the income earned by the estate. This is a problem that is not covered in Oregon -- that is, whether or not this general rule and the distinction between an outright bequest and a bequest in trust is the law in Oregon or should be the law in Oregon.

"Residue. The present rule and the Restatement rule is that gifts of the entire residue or a portion of the residue in trust and a portion outright all are entitled to share pro rata in the income.

"With respect to the so-called pre-residuary legacies, I don't believe there is any significant problem that needs to be resolved except in the limited situations where people are using pecuniary marital deduction bequests or a pre-residuary marital bequest or pecuniary or net estate type bequests where you don't give a fractional share of the residual estate. This area is not covered by the Uniform Principal and Income Act revision and I think probably needs to be covered because a pecuniary gift intended to take advantage of the marital deduction is certainly to be distinguished from a pecuniary bequest of \$10,000 or \$25,000 to a person other than the testator's spouse. I think that the pre-residuary marital deduction, whether it be pecuniary or not, should receive a pro rata share of the income.

"To go back to the problem of the allocation of income to the pre-residuary legatees. Where a general legacy of \$250,000 is given to A and the residue to B with a provision that all of the taxes and expenses be paid out of the residue, the problem is whether you start out by taking the inventory values of the gross estate and \$250,000 over that inventory value times the income to determine what the recipient gets

throughout the period of administration, or whether you try to determine what will be the net residue available for actual distribution and make an allocation of income on the basis of \$250,000 over that net. These two methods are called the gross share or the net share methods.

"The so-called gross share rule, where you allocate on the basis of inventory values, without adjustment, is the easiest method. It is not the most equitable because of the fact that the recipient of the general legacy is not actually getting his share of the total income after the taxes and expenses are paid. Of course, the net share rule has the disadvantage of being more difficult and also has inequities.

"The answer to the problem, which is suggested by the revision to the Uniform Principal and Income Act, is to require periodic adjustments in the ratio of the value of general legacy to the entire estate at each time when you make at least a major expenditure. These adjustments would be made when you paid such things as inheritance taxes, attorneys' fees, executor's commission, federal estate tax. \*\*\*

"The same problem arises much more often and with much more case authority when you are concerned with the allocation of income among residuary legatees and there is a provision in the will for payment of these expenses or taxes out of a particular share of the residue only. What do you do in these instances? Do you apply the gross share, the net share or the periodic adjustment rule? The same problem occurs in the area of charitable bequests where you have a charitable bequest which is out of the residue, but is not going to bear a portion of the taxes.

"In each of these areas, the solution proposed by the revised Principal and Income Act is the periodic adjustment rule. This is far and away the most equitable rule and certainly when you get into estates where there are significant amounts of income, it can make a substantial difference whether a residuary legatee's share of the estate is going to be reduced at the end of 15 months by a substantial amount to pay federal estate taxes. At that time the executor should make an adjustment and establish a new ratio of the shares of the residue remaining and carry that ratio forth from that time, at all times using inventory values for this purpose.

"One thing which I did not touch on and which is a problem that is more crucial in Oregon than in many jurisdictions is raised by a case which many of you may be familiar with, In

re Feehely's Estate, 179 Or. 250. There the court held that income on assets which are expended and which will never become a part of the residue of the estate, is to be added to the residue and not distributed as income for the reason that the testator never really intended the income beneficiary to get the income earned on those assets. This is the English rule. It was then but no longer is the general rule. The court relied extensively on the fact that it was the general rule and the rule of the Restatement of Trusts which it no longer is. No one has taken this problem to the Supreme Court again so we are bound by that decision and to some extent, it affects the general question of whether or not you make periodic adjustments. It does in effect adopt the net share rule.

\*\*\* Section 5 of the Revised Uniform Principal and Income Act which was adopted by the National Conference of Commissioners in 1962... has never been considered by the Oregon State Bar Committee on Uniform Laws. It is, to my way of thinking, at least the first step in the solution to the problem. The only other way is if you draft your will with detailed instructions as to how income should be allocated. Unfortunately many attorneys today are not aware of the problems in this area and wills are drafted without these problems in mind.

"The provision... would either have to be adopted as a part of the Uniform Principal and Income Act or it would have to become a part of the general probate code. This provision still leaves it available to the testator's attorney to draw a will which will change the results of the Act. However, it does contain specific detail covering most of the problems I have just discussed and what will happen if there is no language in the will to cover the problem. It adopts the more equitable rule, the combination of the gross share and net share rule, requiring periodic adjustments. The Act also provides that income received by a trustee under this subsection should be treated as income of the trust. Subparagraph (b) you will note is contrary to the Feehely rule.

"My recommendation is that the revised Uniform Principal and Income Act makes a substantial step forward and I think it is the right step in solving this problem. I have only one suggested change and that is that some language should be inserted to make it clear that the legatee of a pecuniary bequest which is intended to take advantage of the marital deduction provisions of the Internal Revenue Code would also share in the income in the same way as a residuary legatee."

(See October 1963 issue of Trusts and Estates, page 916; also see, 2 ALR3d, p. 1061; III Scott on Trusts, Sec. 234.)

Proposed revised Oregon probate code  
ALLOCATION OF INCOME  
2nd Draft  
December 22, 1967

Prepared by  
Stanton W. Allison

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As used in this subparagraph, remaining income means the total income from all property which is not specifically devised, less the taxes, ordinary repairs, and other expenses incurred in the management and operation of all such property from which the estate is entitled to income, any interest paid during the period of administration on account of such property, and the taxes imposed on income (excluding taxes on capital gains) which are paid during the period of administration, and which are not charged against the property specifically devised.

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