

Memorandum 87-69

Subject: Study L-1024 - Interest and Income Accruing During
Administration (Draft of Tentative Recommendation)

Attached to this memorandum is a redrafted version of the tentative recommendation relating to interest and income accruing during estate administration. The redrafted version incorporates the most recent Commission decisions on this matter made at the July meeting in Irvine. There are a few staff notes in the draft that the Commission should review.

Respectfully submitted,

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Staff Draft

TENTATIVE RECOMMENDATION

relating toINTEREST AND INCOME
ACCRUING DURING ADMINISTRATIONExpenses On Property Specifically Devised

Under existing law, expenses on specifically devised property during administration are charged first to any income from the property, and then to the residue as an expense of administration,¹ except that if the property is occupied rent free by the devisee, the devisee is charged with the expenses whether or not the property produces income.² The proposed law qualifies this rule by limiting the time such expenses are paid out of the estate to one year after the testator's death and by making clear that expenses paid out of the estate are a charge against the share of the specific devisee. Payment of expenses out of the estate is done as a convenience for the devisee who may have at the time no way of paying the expenses other than sale of the property. This convenience should not, however, have the effect of impairing the rights of other estate beneficiaries.

Rate Of Interest On Unpaid Devises

Under existing law, the rate of interest on a general pecuniary devise or on an overdue periodic payment is ten percent.³ This rate is higher than the likely return on funds being held by the estate, and therefore imposes an unfair penalty on the estate. The proposed law reduces the interest rate to the minimum rate that would be payable on

1. McCarroll, 1 California Decedent Estate Supplement § 17.9, at 452 (Cal. Cont. Ed. Bar, June 1985).

2. Estate of Reichel, 28 Cal. App. 3d 156, 103 Cal. Rptr. 836 (1972).

3. The rate of interest is that payable on a money judgment entered in this state. Prob. Code §663. The rate of interest on a money judgment is ten percent. Code Civ. Proc § 685.010.

a United States Series EE savings bond, if purchased on the date of the testator's death and held for at least five years. The current rate is 5.75 percent.⁴

Marital Deduction Gift

The proposed law continues the existing rule that interest on an unpaid general pecuniary devise commences one year after testator's death.⁵ If applied to a marital deduction under a formula clause, however, this rule might decrease the value of the deduction,⁶ contrary to testator's intent. To avoid this result, the proposed law provides that a general pecuniary devise intended to qualify for the marital deduction bears interest from the date of death.⁷

Interest on Trust Distributions

Although the Revised Uniform Principal and Income Act is a well-developed scheme for allocating interest and income that accrue during trust administration to the income and remainder beneficiaries of the trust,⁸ the Act fails to address the issue of distributions from the trust. The proposed law parallels the law applicable to probate estate administration: if a distribution from a trust is not made when due, the amount of the distribution accrues interest from the date it is due. In the case of a required distribution of current

4. This rate is 85% of the average return on five-year Treasury marketable securities rounded to the nearest one-quarter percent. A new rate is fixed every six months and is readily ascertainable. By using the rate of interest on savings bonds on the date interest commences to run, the proposed law avoids having to recalculate interest every six months.

5. Prob. Code § 663(a).

6. See Drafting California Revocable Living Trusts § 4.27, at 131 (Cal. Cont. Ed. Bar 1984); cf. Halstead, *The Marital Deduction*, in California Will Drafting Practice § 6.16, at 240 (Cal. Cont. Ed. Bar 1982).

7. In all other respects, the proposed law continues the substantive effect of existing law concerning allocation of interest and income accruing during administration. Prob. Code §§ 660-665.

8. Prob. Code §§ 16300-16313.

income, the proposed law makes clear that the income is payable not less frequently than annually.⁹

9. The proposed law omits Probate Code Section 661 ("[i]n case of a bequest of the interest or income of a certain sum or fund, the interest or income accrues from the testator's death"). This omission is not a substantive change. Although the language "a certain sum or fund" is ambiguous, the cases have interpreted it to mean a testamentary trust. See, e.g., Estate of Petersen, 92 Cal. App. 2d 677, 682, 207 P.2d 607 (1949). The question of when income from a testamentary trust commences is governed by Probate Code Section 16304(a) (income commences at death if trust instrument is silent).

The question of when an income beneficiary is entitled to income from the trust must be distinguished from the question of when interest on a devise to the trust commences. Under the proposed law as well as existing law (Prob. Code § 663(a)), interest on a pecuniary devise in trust commences one year after death. If the trust is funded entirely by a pecuniary devise, the trust will have no income until either the devise is distributed to the trust or until the trust becomes entitled to interest on the undistributed devise (one year after death). Thus, although the Revised Uniform Principal and Income Act provides that an income beneficiary is entitled to income from the date of death (Prob. Code § 16304(a)), if the devise is not distributed to the trust during the first year after death, there will be no income during this period for the trust to distribute to the income beneficiary.

Outline

Prob. Code §§ 660-665 (repealed). Legacies and interest

Prob. Code § 6154 (added). Classification of devises

Prob. Code §§ 12000-12007 (added)

DIVISION 7. ADMINISTRATION OF ESTATES OF DECEDENTS

PART 10. DISTRIBUTION OF ESTATE

CHAPTER 8. INTEREST AND INCOME ACCRUING

DURING ADMINISTRATION

§ 12000. Application of chapter

§ 12001. Rate of interest

§ 12002. Income on and expenses of specific devise

§ 12003. Interest on general pecuniary devise

§ 12004. Annuity; interest on annuity or devise for maintenance

§ 12005. Remaining income to residuary or intestate distributees

§ 12006. Reference to former law

§ 12007. Transitional provision

Prob. Code § 16304 (amended). When right to interest accrues; apportionment of income

Prob. Code § 16305 (amended). Income earned during administration of decedent's estate

Prob. Code § 16314 (added). Interest on trust distributions

APPENDIX

DISPOSITION OF EXISTING SECTIONS

Probate Code §§ 660-665 (repealed). Legacies and interest

SECTION 1. Chapter 11 (commencing with Section 660) of Division 3 of the Probate Code is repealed.

Comment. For the Comments to the repealed sections of former Chapter 11 (commencing with Section 660) of Division 3, see the Appendix to this recommendation.

Probate Code § 6154 (added). Classification of devises

SEC. . Section 6154 is added to the Probate Code, to read:

6154. Devises are classified as follows:

(a) A specific devise is a devise of specifically identifiable property.

(b) A general devise is a devise from the general estate that does not give specific property.

(c) A demonstrative devise is a general devise that specifies the fund or property from which the devise is primarily to be made.

(d) An annuity is a general devise of a specified amount that is payable periodically.

(e) A general pecuniary devise is a pecuniary gift within the meaning of Section 21120 [AB 708] that is made by will.

(f) A residuary devise is a devise of property that remains after all specific and general devises have been satisfied.

Comment. Subdivision (a) of Section 6154 restates a portion of former Section 662(a) without substantive change. See also Estate of Ehrenfels, 241 Cal. App. 2d 215, 221, 50 Cal. Rptr. 358 (1966).

Subdivision (b) supersedes former Section 662(e) and is consistent with case law under the former provision. See, e.g., Estate of Jones, 60 Cal. App. 2d 795, 798, 141 P.2d 764 (1943).

Subdivision (c) restates former Section 662(b) without substantive change. The reference in subdivision (c) to a demonstrative devise as a "general" devise is new, but is consistent with prior law. See former Section 662(c) (if indicated fund fails, resort may be had to general assets as in case of general devise); 7 B. Witkin, Summary of California Law Wills and Probate § 214, at 5725 (8th ed. 1974) (same); Estate of Cline, 67 Cal. App. 2d 800, 805-05, 155 P.2d 390 (1945) (demonstrative devise is "in the nature of" a general devise; reference to particular fund is for convenient method of payment); Johnston, Outright Bequests, in California Will Drafting § 11.92, at 401 (Cal. Cont. Ed. Bar 1965) (demonstrative devise is "similar to" general devise). For the priority that a demonstrative devise has over other general devises, see Section 21401(b).

Subdivision (d) restates the first clause of former Section 662(c) without substantive change. The reference in subdivision (d) to an annuity as a "general" devise is new, but is consistent with the last clause of former Section 662(c) (if indicated fund fails, resort may be had to general assets as in case of general devise) and with case law. See Estate of Luckel, 151 Cal. App. 2d 481, 493-95, 312 P.2d 24 (1957) (annuity is a "general charge on the testator's whole estate"). For the priority that an annuity has over other general devises, see Section 21401(b).

Subdivision (e) is new. It incorporates the definition of "pecuniary gift" provided in Section 21120(b) [AB 708] ("pecuniary gift" means a transfer of property made in an instrument that either is expressly stated as a fixed dollar amount or is a dollar amount determinable by the provisions of the instrument).

Subdivision (f) restates former Section 662(f) without substantive change.

CROSS-REFERENCES

Definitions

Devise § 32

Property § 62

Will § 88

Probate Code §§ 12000-12007 (added). Interest and income accruing during administration

SEC. 4. Chapter 8 (commencing with Section 12000) is added to Part 10 of Division 7 of the Probate Code, to read:

CHAPTER 8. INTEREST AND INCOME ACCRUING DURING ADMINISTRATION

§ 12000. Application of chapter

12000. The provisions of this chapter apply where the intention of the testator is not indicated by the will.

Comment. Section 12000 restates without substantive change former Section 660 and the introductory clause of former Section 664(a). The language of Section 12000 is drawn from Sections 6140(b) and 6165 (rules of construction of wills).

CROSS-REFERENCES

Definitions

Will § 88

§ 12001. Rate of interest

12001. When interest is payable under this chapter:

(a) The rate of interest is the minimum rate payable on a United States savings bond, Series EE, if purchased on the date interest commences to run and held for at least five years. If there is no minimum rate payable on a United States savings bond, Series EE, the rate of interest is three percent less than the legal rate on judgments on the date interest commences to run.

(b) The rate of interest provided in subdivision (a) shall remain fixed at the applicable rate in effect on the date interest commences to run and shall not be recomputed in the event of a change in the applicable rate thereafter.

Comment. Section 12001 supersedes portions of subdivisions (a) and (c) of former Section 663. Under former Section 663, the rate of interest was that payable on a money judgment entered in this state. The rule of Section 12001 applies where the intention of the testator is not indicated by the will. Section 12000 (application of chapter).

§ 12002. Income and expenses of specific devise

12002. (a) Except as provided in subdivision (b), a specific devise does not bear interest.

(b) A specific devise carries with it income on the devised property from the date of death, less taxes and other expenses attributable to the devised property during administration of the estate.

(c) If income of specifically devised property is not sufficient to pay expenses attributable to the property, including taxes on the property, the deficiency shall be paid out of the estate until the earliest of the following times:

(1) One year after the testator's death.

(2) The date the property is distributed to the devisee.

(3) The date the devisee takes possession of or occupies the property.

(d) A deficiency paid out of the estate under subdivision (c) is a charge against the share of the devisee. The personal representative has an equitable lien on the specifically devised property as against the devisee in the amount paid out.

Comment. Section 12002 is new. Section 12002 applies to specific devises of real and personal property. See Section 32 ("devise" defined). The rule of Section 12002 applies where the intention of the testator is not indicated by the will. Section 12000 (application of chapter).

Subdivision (a) codifies case law. See, e.g., In re Estate of Daly, 202 Cal. 284, 287, 260 P. 296 (1927) (stock).

Subdivision (b) codifies case law. See Estate of McKenzie, 199 Cal. App. 2d 393, 399-400, 18 Cal. Rptr. 680 (1962) (inheritance from another estate).

Paragraphs (2) and (3) of subdivision (c) are consistent with Estate of Reichel, 28 Cal. App. 3d 156, 103 Cal. Rptr. 836 (1972) (where specifically devised real property produces no income but is occupied rent free by the devisee from testator's death, expenses on the property are chargeable to the devisee). Expenses attributable to a specific devise that are paid out of the estate pursuant to subdivision (c) are ultimately borne by the distributee of the property. See Subdivision (d).

The equitable lien imposed by subdivision (d) is not good against a transferee of the property who gives fair consideration for the property without knowledge of the lien. See generally 1 J. Pomeroy, Equity Jurisprudence §§ 165, 171(4) (5th ed. 1941); cf. Section 15685 and the Comment thereto (trustee's lien).

CROSS-REFERENCES

Definitions

Devise § 32

Devisee § 34

Personal representative § 58

Property § 62

§ 12003. Interest on general pecuniary devise

12003. (a) Except as provided in subdivision (b), if a general pecuniary devise, including a general pecuniary devise in trust, is not distributed before the first anniversary of the testator's death, the devise bears interest thereafter.

(b) A general pecuniary devise, including a general pecuniary devise in trust, that is a marital deduction gift within the meaning of Chapter 2 (commencing with Section 21520) of Part 5 of Division 11 [AB 708], bears interest from the date of the testator's death.

Comment. Subdivision (a) of Section 12003 restates former Section 663(a), except that the rate of interest is specified in Section 12001. The rule of subdivision (a) applies where the intention of the testator is not indicated by the will. Section 12000 (application of chapter). Where the will makes a marital deduction gift, subdivision (b) requires that interest runs from the date of the testator's death.

CROSS-REFERENCES

Definitions

Devise § 32

Trust § 82

Rate of interest § 12001

Note. Subdivision (a), which starts interest on a general devise in trust one year after the testator's death, is at odds with the rest of California probate and trust law. A devise of specific property in trust carries with it the income of the trust property from the date of death, as does a residuary devise in trust. See Sections 12002 and 12005.

The rule of subdivision (a) also conflicts with the Revised Uniform Principal and Income Act. Under that law an income beneficiary of a trust is entitled to trust income from the date of death. Section 16304(a). The consequence of this conflict is not clear. During the first year of probate administration, any interest on a share to be distributed in trust goes to the residuary beneficiaries rather than to the trust. Presumably the trust income beneficiary's share is taken ultimately from the trust remainder beneficiaries once the corpus is distributed to the trust. In essence, probate residuary beneficiaries would be favored at the expense of trust remainder beneficiaries. However, there is no case addressing this point, and another possible interpretation is simply that there is no trust income during probate administration, hence the income beneficiary gets nothing. This is the analysis made in footnote 9 of the preliminary part of this tentative recommendation.

The rule of subdivision (a) was added to California law in 1959 as the result of a State Bar Conference of Delegates proposal. The object of the proposal was to treat all general devises, whether outright or in trust, the same. At the time the Conference of Delegates bill was pending, a bill proposing enactment of the Revised Uniform Principal and Income Act was also pending, which contained conflicting provisions. The RUPIA bill was referred to interim study and the Conference of Delegates bill was enacted. Eight years later the RUPIA was enacted, but subdivision (a) was never adjusted, thereby building the existing conflict into the law.

The staff believes it would be appropriate to eliminate trusts from subdivision (a). Subdivision (b) would provide that a general devise in trust carries interest from the date of death. This would treat all devises in trust consistently, whether specific, general, residuary, marital deduction, or otherwise. Of course, it would still treat general devises free of trust differently from general devises in trust. We are not sure of the policy reasons for delaying the running of interest on a general devise not in trust, and it might make sense to run interest on all general devises, whether or not in trust, from the date of death.

§ 12004. Annuity; interest on annuity or devise for maintenance

12004. (a) An annuity commences at the testator's death and shall be paid at the end of the annual, monthly, or other specified period.

(b) Whenever an annuitant or a devisee of a devise for maintenance is entitled to periodic payments commencing at the testator's death, the annuitant or devisee is entitled to interest on the amount of any unpaid accumulations of the payments or income held by the personal representative on each anniversary of the decedent's death, computed from the date of the anniversary.

Comment. Subdivision (a) of Section 12004 restates former Section 663(b) without substantive change.

Subdivision (b) restates former Section 663(c), except that the provision governing the interest rate is superseded by Section 12001 and the provision governing an income beneficiary of a trust is superseded by Section 16304 (when right to income arises).

The rule of Section 12004 applies where the intention of the testator is not indicated by the will. Section 12000 (application of chapter).

CROSS-REFERENCES

Definitions

Devise § 32

Devisee § 34

Personal representative § 58

Trust § 82

Rate of interest § 12001

Note. The staff has deleted from this section a reference to interest on unpaid accumulations held by a personal representative for a trust income beneficiary. This matter would be governed by Section 16304 (when right to income arises).

§ 12005. Remaining income to residuary or intestate distributees

12005. (a) Net income received during administration not paid under other provisions of this chapter and not otherwise devised shall be distributed pro rata as income among all distributees who receive either residuary or intestate property. If a distributee takes for life or for a term of years, the pro rata share of income belongs to the tenant for life or for the term of years.

(b) Net income under subdivision (a) includes net income from property sold during administration.

Comment. Section 12005 supersedes former Section 664. The former reference to a distribution to a beneficiary in trust as income to the trust is omitted; this matter is governed by Section 16305(a) (Revised Uniform Principal and Income Act). The reference to intestate property is new, and recognizes that there may be a partial intestacy in a testate estate. The rule of Section 12005 applies to a person who receives either or both testate and intestate property.

The rule of Section 12005 applies where the intention of the testator is not indicated by the will. Section 12000 (application of chapter).

CROSS-REFERENCES

Definitions

Devise § 32
Property § 62
Trust § 82

§ 12006. Reference to former law

12006. A reference in a written instrument, including a will or trust, to a provision of former Chapter 8 (commencing with Section 160) of Division 1, or former Chapter 11 (commencing with Section 660) of Division 3, shall be deemed to be a reference to the corresponding provision of this chapter.

Comment. Section 12006 continues the substance of subdivision (b) of former Section 665, and includes a reference to former Chapter 11 of Division 3 in which former Section 665 was found.

CROSS-REFERENCES

Definitions

Will § 88
Trust § 82

§ 12007. Transitional provision

12008. This chapter applies only in cases where the decedent died on or after July 1, 1989. In cases where the decedent died before July 1, 1989, the law that would have applied had the law that enacted this chapter not been enacted shall apply.

Prob. Code § 16304 (amended), When right to income arises; apportionment of income

SEC. . Section 16304 of the Probate Code is amended to read:

16304. (a) An income beneficiary is entitled to income from the date specified in the trust instrument or, if none is specified, from the date an item of property becomes subject to the trust. In the case of an item of property becoming subject to a trust by reason of a person's death, it becomes subject to the trust as of the date of death of the person even though there is an intervening period of administration of the person's estate, and bears interest as provided in Section 16314.

(b) Upon property becoming subject to a trust by reason of a person's death:

(1) Receipts due but not paid at the date of death of the person are principal.

(2) Receipts in the form of periodic payments (other than corporate distributions to stockholders), including rent, interest, or annuities, not due at the date of the death of the person shall be treated as accruing from day to day. That portion of the receipt accruing before the date of death is principal and the balance is income.

(c) In all other cases, any receipt from income-producing property is income even though the receipt was earned or accrued in whole or in part before the date when the property became subject to the trust.

(d) If an income beneficiary's right to income ceases by death or in any other manner, all payments actually paid to the income beneficiary or in the hands of the trustee for payment to the income beneficiary before such termination belong to the income beneficiary or to his or her personal representative. All income actually received by the trustee after such termination shall be paid to the person next entitled to income by the terms of the trust. This subdivision is subject to subdivision (d) of Section 21524 and does not apply to income received by a trustee under subdivision (b) of Section 16305.

(e) Corporate distributions to stockholders shall be treated as due on the day fixed by the corporation for determination of stockholders of record entitled to distribution or, if no date is fixed, on the date of declaration of the distribution by the corporation.

Comment. Section 16304 is amended to make clear that the rules governing accrual of interest on trust distributions apply to testamentary distributions in trust from the date of death notwithstanding an intervening period of trust administration. See Section 16314 (interest on trust distributions).

Prob. Code § 16305 (amended). Income earned during administration of decedent's estate

SEC. . Section 16305 of the Probate Code is amended to read:

16305. Unless the will otherwise provides, income from the property of a decedent's estate after the death of the testator and before distribution, including income from property used to discharge liabilities, shall be distributed in the manner set forth in ~~Chapter 11 (commencing with Section 660) of Division 3~~ Chapter 8 (commencing with Section 12000) of Part 10 of Division 7. Income received by a trustee under this subdivision shall be treated as income of the trust.

(b) When an income beneficiary's right to income, including interest payable under Section 663 16304, ceases by death or in any other manner during the period of probate administration, income attributable to the period prior to the termination of such right, when subsequently received by the trustee, shall be equitably prorated between the beneficiary or his or her personal representative and the person next entitled to income by the terms of the trust instrument.

Comment. Subdivision (a) of Section 16305 is amended to correct section references. Subdivision (b) is amended to reflect the repeal of separate probate administration provisions relating to interest on the share of a trust income beneficiary; these provisions are superseded by Sections 16304 (when right to income arises) and 16314 (interest on trust distributions).

Prob. Code § 16314 (added). Interest on trust distributions

SEC. . Section 16314 is added to the Probate Code, to read:

16314. If a distribution under a trust, whether to an income beneficiary or a remainder beneficiary and whether outright or subject to a further trust, is not made on the date when the distribution is payable, the amount of the distribution bears interest thereafter at the rate provided in Section 12001. In the case of a beneficiary of current income, the distribution is payable not less frequently than annually.

Comment. Section 16314 is new. It governs interest payable during probate as well as interest during trust administration. See Section 16304 (when right to income arises; apportionment of income).

APPENDIX

DISPOSITION OF EXISTING SECTIONS

DIVISION 3. ADMINISTRATION OF ESTATES OF DECEDENTS

CHAPTER 11. LEGACIES AND INTEREST

§ 660 (repealed). Testator's intention controls

Comment. Former Section 660 is restated in Section 12000 without substantive change.

§ 661 (repealed). Request of interest or income of certain sum

Comment. Former Section 661 is superseded by Section 16304(a) (Revised Uniform Principal and Income Act).

§ 662 (repealed). Kinds of legacies

Comment. The first portion of subdivision (a) of former Section 662 is restated in Section 6154(a) (specific devise) without substantive change. The last portion of subdivision (a) (if specific gift fails, resort cannot be had to testator's other property) is superseded by Sections 21401 (order of abatement) and 6171-6173 (ademption).

Subdivision (b) is restated in Section 6154(c) (demonstrative devise) without substantive change.

The first portion of subdivision (c) is restated in Section 6154(d) (annuity) without substantive change. The last portion of subdivision (c) is restated in Section 21403(b) (abatement within classes) without substantive change.

Subdivision (d) is restated in Section 6142(f) (residuary devise) without substantive change.

Subdivision (e) is superseded by Section 6154(b) (general devise).

§ 663 (repealed). Interest; annuities

Comment. The provision of subdivision (a) of former Section 663 that interest on a general pecuniary legacy commences one year after death is restated in Section 12003 without substantive change. The provision of subdivision (a) that the rate of interest is that payable on a money judgment entered in this state is superseded by Section 12001.

Subdivision (b) is continued in Section 12004(a).

Subdivision (c) is restated in Section 12004(b) (interest on unpaid periodic payments), except that the provision governing the interest rate is superseded by Section 12001 and the provision governing an income beneficiary of a trust is superseded by Section 16304(a) (when right to trust income arises).

§ 664 (repealed). Distribution of income from certain property

Comment. Subdivision (a) of former Section 664 is superseded by Sections 12000 (application of chapter) and 12005 (remaining income to residuary or intestate distributees).

Subdivision (b) is superseded by Section 16305(a) (Revised Uniform Principal and Income Act).

§ 665 (repealed). Transitional provision

Comment. Subdivision (a) of former Section 665 is generalized in Section 2(a). Subdivision (b) is continued in Section 12006 without substantive change.