#L-1024

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Memorandum 87-89

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

The tentative recommendation relating to interest and income accruing during administration was distributed for comment in September. Copies of the comments received concerning the tentative recommendation are attached to this memorandum as Exhibits 1-18. The comments are analyzed following the sections to which they relate in the attached edited version of the tentative recommendation.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

TENTATIVE RECOMMENDATION

relating to

INTEREST AND INCOME
ACCRUING DURING ADMINISTRATION

Expenses 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 charged against the estate to one year after the testator's death; any expenses paid out of the estate after one year 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 if administration is prolonged beyond a year.

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

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1. McCarroll, 1 California Decedent Estate Supplement § 17.9, at 452 (Cal. Cont. Ed. Bar 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 Series EE United States savings bond purchased one year after the date of the testator's death and held to maturity. The current rate is 5.84 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. *THE LAW REVISION COMMISSION PARTICULARLY SOLICITS COMMENTS CONCERNING THE WISDOM OF THIS RECOMMENDATION.*

Interest on Trust Distributions

Although the California Revised Uniform Principal and Income Act is a well-developed scheme for allocating to the income and remainder beneficiaries of the trust interest and income that accrue during trust administration,[7] 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

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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 specifying the rate of interest on savings bonds one year after the date of death, the proposed law uses a date close to the time interest must be computed and avoids having to recalculate interest every six months.

5. Prob. Code § 663(a).

6. *Cf.* Halstead, *The Marital Deduction,* in California Will Drafting Practice § 6.16, at 240 (Cal. Cont. Ed. Bar 1982).

7. Prob. Code §§ 16300-16313.

income, the proposed law makes clear that the income is payable at least annually.[8]

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8. 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 California 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

SEC. . 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.

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

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

(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, 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 ~~(e)~~ (d) 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 ~~(d)~~ (e) restates the first clause of former Section 662(c) without substantive change. The reference in subdivision ~~(d)~~ (e) 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 (f) restates former Section 662(f) without substantive change.

CROSS-REFERENCES

Definitions
  Devise § 32
  Property § 62
  Will § 88

Note. Everett Houser of Long Beach (Exhibit 3) thinks subdivision (b) is a valuable addition.

The staff has incorporated editorial suggestions of Richard S. Kinyon of San Francisco (Exhibit 6), shown in strikeout and underscore.

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

SEC. . 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. If interest is payable under this chapter:

(a) The rate of interest is the minimum rate that would be payable on a Series EE United States savings bond purchased one year after the date of the decedent's death and held to maturity. If there is no minimum rate payable on a Series EE United States savings bond, the rate of interest is three ~~percent~~ *percentage points* less than the legal rate on judgments in effect one year after the date of the decedent's death.

(b) The rate of interest provided in subdivision (a) shall remain fixed at the applicable rate in effect one year after the date of the decedent's death 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). The minimum rate payable on a Series EE United States savings bond may be obtained from a financial institution or from the U.S. Savings Bond Division of the Department of Treasury (1-800-U.S.BONDS).

Note. Existing law provides a 10% interest rate on unpaid devises, whereas this section reduces the rate to the rate applicable to a Series EE United States savings bond (5.84%) or, if none, three percent less than the legal rate on judgments (7%).

Reduction of interest rate. A number of commentators agreed with the basic concept of reducing the rate of interest on unpaid devises. See, e.g., Stephen I. Zetterberg of Claremont (Exhibit 7) ("It does seem fair to reduce the penalty on overdue periodic payments below ten percent. Income on funds held during administration is apt to be lower than income that an owner, freed from estate investment restrictions, could make."); State Bar Executive Committee (Exhibit 12) ("The Committee agreed that a more realistic, interest-sensitive rate should be charged."); Stuart D. Zimring of North Hollywood (Exhibit 17) ("I have always felt that the rate of interest paid on general pecuniary devises was too high for the same reasons you indicate in the proposals. Therefore, I support the reduction of the interest rate.")

On the other hand, a number of commentators urged a higher percentage. See, e.g., Jerome Sapiro of San Francisco (Exhibit 1) ("A higher rate of interest may be an inducement to strive for earlier distribution. A personal representative should not be able to delay distribution, collect higher interest for the estate, and pay less to the distributee.") A similar sentiment was expressed at length by Wilbur L. Coats of Poway (Exhibit 5), who concludes, "It seems to me by lessening the interest rate on pecuniary devises less emphasis will be placed on getting money distributions out to the beneficiaries. I

suggest the present ten percent (10%) remain with a provision that the court may reduce it to a lesser interest as suggested in your tentative proposal if the court finds good reason to pay the lesser interest."

Rate of interest. Although most commentators agreed with the concept of a lower interest rate, there were many different opinions as to what that rate should be. Only one commentator thought that the minimum rate payable on a Series EE United States savings bond was a reasonable measure. See Exhibit 9 (San Mateo County Superior Court). Reasons given for opposition include:

(1) The rate is too low. Jerome Sapiro of San Francisco (Exhibit 1). [We were trying to pick a rate close to what a personal representative would reasonably be expected to earn, e.g., a passbook account or money market fund or other short term investment.]

(2) Bonds of that type can go out of existence. Jerome Sapiro of San Francisco (Exhibit 1); Stephen I. Zetterberg of Claremont (Exhibit 7). [We cover this eventuality in the draft by providing a backup rate of 3 points less than the rate on judgments, which currently stands at 10%; apparently the persons who objected on this ground read only the preliminary part of the recommendation, which does not mention the fallback position, and failed to read the text of the statute itself, which does.]

(3) The rate is not a simple rounded number and the method of computation is too technical. Paul Gordon Hoffman of Los Angeles (Exhibit 4); Everett Houser of Long Beach (Exhibit 3). [A simple pocket calculator should be able to compute a decimal-place percentage as easily as any other.]

(4) The current rate would not be readily available to practitioners. Paul Gordon Hoffman of Los Angeles (Exhibit 4). [We included a toll-free number in the Comment; however, recently the staff has gotten a busy signal when trying to reach the number. Any financial institution can give you the current rate.]

(5) The relevant EE rate would be difficult to reconstruct if the estate is held up by reason of litigation or other complications. John H. Pitts of Fullerton (Exhibit 10). [True; but so would any variable rate.]

Nearly all the commentators favored a variable rate, rather than a flat percentage rate. There was quite a variety of flexible rates offered for the Commission's consideration:

(1) Three percentage points below the rate payable on money judgments. This was the most popular choice, approved by Everett Houser of Long Beach (Exhibit 3), Stephen I. Zetterberg of Claremont (Exhibit 7), John H. Pitts of Fullerton (Exhibit 10), and Jerome Sapiro of San Francisco (Exhibit 1) (apparently). Among the arguments given for use of this rate are that it is sufficiently high above the current passbook rate to provide an inducement to settle, without unduly penalizing the estate; that it is easy to understand and use, and is easily determined from resources within the average law office; and that the Legislature does change the rate on judgments from time to time, indicating a sensitivity to fluctuation of interest rates.

(2) Rate on income tax refunds, or the imputed interest rate provided under Section 7872 of the Internal Revenue Code. This alternative is offered by Paul Gordon Hoffman of Los Angeles (Exhibit

4), who points out these rates are published by the Internal Revenue Service, are changed every six months, and are easy for practitioners to determine.

(3) The charge on loans to depository institutions by the New York Federal Reserve Bank (the "discount rate"). This standard is offered by the State Bar Executive Committee (Exhibit 12), on the basis that it is available in practically every major city paper, it is not a volatile rate, and it tends to be slightly lower than, and to lag increases in, general market interest rates. The discount rate is currently 6%.

§ 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 property is distributed to the devisee or the devisee takes possession of or occupies the property, whichever occurs first. To the extent a deficiency paid out of the estate is attributable to the period that commences one year after the testator's death, the amount paid is a charge against the share of the devisee, and the personal representative has an equitable lien on the specifically devised property as against the devisee in the amount paid.

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).

The first sentence of subdivision (c) is 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). The second sentence of subdivision (c) limits the burden on the estate to the first year

after the decedent's death. Expenses paid out by the estate after the first year are ultimately borne by the distributee of the property. The equitable lien imposed by subdivision (c) 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

Note. Under existing case law, the estate must pay expenses on specifically devised property during administration if the income from the property is insufficient. Subdivision (c) of this section limits the time the estate can be made to bear these expenses to the first year of administration only. Everett Houser of Long Beach (Exhibit 3) likes this section, as does Stuart D. Zimring of North Hollywood (Exhibit 17) and the San Mateo County Superior Court (Exhibit 9). The State Bar Executive Committee (Exhibit 12) is more expressive in its support. "Most of the members of the Committee felt that the proposed changes represented a fair and equitable compromise of the issue of who should bear the expenses for specifically devised property."

The Bar Committee was not unanimous, however, and noted that a few of its members strongly felt that expenses on specifically devised property should be borne entirely by the specific devisee (the residue should never bear this burden). This position is elaborated by William L. Hoisington of San Francisco (attached to Exhibit 12), who argues that the person benefitting should bear the burden. "There is nothing objectionable about the executor being empowered (but not required) to advance the property of the residuary devisees to meet the obligations of a specific devisee with respect to the property of such specific devisee. But, if the executor does so, the residuary devisees should be fully reimbursed by the specific devisee or from the specifically devised property itself--with compensating market interest."

Paul Gordon Hoffman of Los Angeles (Exhibit 4), on the other hand, is concerned that a specific devisee will be penalized in a case where it is not possible to distribute the property right away for one reason or another. The specific devisee will be required to pay expenses on the property without any corresponding ownership rights. He suggests it might be preferable to give the court some discretion as to who bears the expense where one of the parties to the estate proceeding contributes to a delay in distribution. The court might also take into account changes in value of the property during the period of delay.

There were also comments addressed to a technical point in the drafting of this provision. As drafted, it requires the specific distributee to cover expenses borne by the estate to the extent "attributable to the period that commences one year after the testator's death." Mr. Hoisington sees problems where an expense

accrued during the first year of administration but was paid later; Jerome Sapiro of San Francisco (Exhibit 1) has the same concern. The staff believes this is covered by the "attributable" language, which would not require the specific devisee to bear that expense. Perhaps it would be useful to add language such as "whether paid during or after expiration of the one year period to which the expense is attributable."

§ 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 within one year after 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. Where the will makes a marital deduction gift, subdivision (b) provides that interest runs from the date of the testator's death. The rule of Section 12003 applies where the intention of the testator is not indicated by the will. Section 12000 (application of chapter).

CROSS-REFERENCES

Definitions
  Devise § 32
  Trust § 82
Rate of interest § 12001

NOTE. The tentative recommendation particularly solicited comments concerning the wisdom of subdivision (b), which runs interest from the date of death in the case of a marital deduction gift. Our tax expert advisers have been quite divided on this matter.

The commentators on this point are likewise divided on this matter. The arguments in favor of running interest from the date of death are:

(1) Federal law requires that interest run from the date of death in order to qualify for the marital deduction. See, e.g., Henry Angerbauer, C.P.A. (Exhibit 8); State Bar Executive Committee (Exhibit 12); Russell G. Allen of Newport Beach (Exhibit 13); Michael Patiky Miller of Palo Alto (Exhibit 15).

(2) Testators who make marital deduction gifts want the greatest amount possible to pass under the gift. See, e.g., Paul Gordon Hoffman of Los Angeles (Exhibit 4).

The arguments opposed to running interest from the date of death disagree with the above analysis:

(1) Federal tax law does not negate the marital deduction if interest does not start to accrue at death; the proposed regulations recognize a reasonable delay on the start of interest during administration, and one year is reasonable. See, e.g., Richard S. Kinyon of San Francisco (Exhibit 6); John H. Pitts of Fullerton (Exhibit 10); Peter L. Muhs of San Francisco (Exhibit 14).

(2) Testators who make marital deduction gifts do not necessarily want all interest to go to the surviving spouse; they may wish interest to go to other beneficiaries for a number of reasons. See, e.g., Richard S. Kinyon of San Francisco (Exhibit 6); Ernest Rusconi of Morgan Hill (Exhibit 18).

(3) Requiring interest on the marital deduction gift could eat into the principal of a bypass gift, which has to pay for it, with undesirable tax consequences. See, e.g., Richard S. Kinyon of San Francisco (Exhibit 6); Peter L. Muhs of San Francisco (Exhibit 14).

(4) The new rule would disrupt many existing estate plans; if adopted it should apply only prospectively. See, e.g., Michael Patiky Miller of Palo Alto (Exhibit 15).

(5) An exception for marital deduction gifts adds undesirable complexity to the probate law; the law should be drafted simply and should not be geared to tax laws, which are changeable; a testator who desires special rules for tax consequences can draft those special rules without disrupting everyone else. See, e.g., Stephen I. Zetterberg of Claremont (Exhibit 7); Stuart D. Zimring of North Hollywood (Exhibit 17).

At least three commentators point out an anomaly in Section 12003. Jerome Sapiro of San Francisco (Exhibit 1), the Legislative Committee of the Beverly Hills Bar Association (Exhibit 11), and William L. Hoisington of San Francisco (attached to Exhibit 12) all note the distinction between interest on a marital deduction gift and income on the gift. Section 12003 as drafted applies only to interest on general pecuniary devises, and not to income on general nonpecuniary devises. A gift of "one-half my estate" would presumably be a general nonpecuniary devise (though this point is debatable). The statute nowhere addresses income on general nonpecuniary devises. Presumably income on general nonpecuniary devises, including marital deduction gifts in the form of general nonpecuniary devises, would be shared proportionately; but the statute may be read to require conversion of general nonpecuniary devises to cash, and payment of interest on the cash. It may be worth stating a rule explicitly in the statute. A number of suggestions have been offered to govern general nonpecuniary devises:

(1) The lesser of actual income or the statutory rate of interest. Hoisington.

(2) The greater of actual income or the statutory rate of interest. Sapiro.

(3) A pro rata share of income. Opel (at a prior Commission meeting).

(4) No interest or income, but all appreciation in value to the date of distribution. Beverly Hills Bar Association.

The staff believes a reasonable approach to this whole problem would be that in the case of a general pecuniary devise, interest runs after one year, whether the devise is a marital deduction gift or not. A general nonpecuniary devise would receive a pro rata share of

income from the date of death, except that a marital deduction gift would receive actual income from the date of death on the property allocated to the gift.

One last point on this section. If we keep a special rule for marital deduction gifts, several commentators argue that the same rule should also apply to charitable deduction gifts. See, e.g., William L. Hoisington of San Francisco (attached to Exhibit 12); Russell G. Allen of Newport Beach (Exhibit 13). Mr. Allen states that "it would be appropriate to expand that to include charitable deduction gifts as well as marital deduction gifts--since conceptually the same problem applies." The State Bar Executive Committee (Exhibit 12) disagrees with this position, but does not give reasons.

§ 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) An annuitant or a devisee of a devise for maintenance 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 testator'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. Richard S. Kinyon of San Francisco (Exhibit 6) does not understand what subdivision (b) means. He suggests the following rephrasing for clarity:

> *(b) If an annuity is not paid at the end of the specified period, it bears interest thereafter, but no interest accrues during the first year after the testator's death.*

The staff notes that under this proposal, no interest would accrue during the first year of estate administration. This would treat the

annuity like other general devises. See Section 12003. After one year, interest would start to accrue immediately and not at the end of a particular year. The proposal also omits reference to a "devise for maintenance", whatever that may be, if something other than a trust or family allowance.

§ 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) (California 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

Note. Everett Houser of Long Beach (Exhibit 3) is concerned about the situation where an instrument refers to a specific provision of old law, which this section converts to a reference to the corresponding provision of new law, but the two provisions may conflict. Mr. Houser suggests that in this situation the old law should govern. The staff agrees that this is a problem and would delete this section.

§ 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~~ income paid to the income beneficiary or ~~in the hands of~~ received by the trustee ~~for payment to the income beneficiary~~ before such termination ~~belong~~ belongs 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~~ estate administration. See Section 16314 (interest on trust distributions).

Note. The editorial revisions in subdivision (d) are suggested by Richard S. Kinyon of San Francisco (Exhibit 6).

The San Mateo County Superior Court (Exhibit 9) is concerned about the implication in subdivision (a) that interest would have to be paid on undistributed trust income even though the trust has never been funded because the trust assets are still tied up in estate administration. The staff is concerned about this implication also. The Commission has considered this matter before and concluded that there is no problem, since a close technical reading of the statutes should yield the conclusion that interest would not have to be paid because there is no income on a general devise in trust during the first year of estate administration. Section 12003.

The staff would deal with this matter head on, rather than relying on one possible, but recondite, construction of the statutes. The staff would state the rule plainly, as follows:

> *(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, except that income on the property during the period of administration is governed by Chapter 8 (commencing with Section 12000) of Part 10 of Division 7, and becomes subject to the trust as it accrues.

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).

Note. This section seeks to provide a rule for when income commences to accrue on trust distributions, analogous to the rules for when income commences to accrue on estate distributions. The San Mateo County Superior Court (Exhibit 9) finds this recommendation reasonable. Paul Gordon Hoffman of Los Angeles (Exhibit 4) strongly supports "any and all efforts to reduce the differences between the probate rules applicable to estates, and the rules governing the administration of living trusts." He urges the Commission to go beyond this limited proposal and incorporate such items as the pretermitted heir statute into trust law.

Stuart D. Zimring of North Hollywood (Exhibit 17) is not sure a mandatory interest provision is called for here, given the almost infinite drafting possibilities in trust distribution clauses; at least the draftsman should be able to write around it. This is already the effect of Section 16302, which provides that the trust instrument controls. We will refer to this provision in the Comment.

Richard S. Kinyon of San Francisco (Exhibit 6) points out that the incorporation of the estate administration interest standard won't work for intervivos trusts since it is geared to the death of the decedent. The staff thinks this is a good point, and would repeat the rate in the trust statute rather than attempting to incorporate it by reference.

Both Mr. Kinyon and Robert K. Maize of Santa Rosa (Exhibit 2) were concerned with the policy of this section running interest from the date a distribution is payable. They point out that frequently under a revocable trust distribution is to be made at the settlor's death, but the trustee may require some time for "administration", to settle questions regarding liabilities of the trust estate and the trustees, and in particular, estate taxes. Also, if interest accrues immediately, the rule governing trusts will differ from the rule governing estates, when our objective here is uniformity. The staff agrees with this analysis, and would provide for a one year delay in accrual of interest where a distribution is to be made at the settlor's death.

Mr. Kinyon would also like to see the last sentence of the section relocated elsewhere, since it is broader than payment of interest. The staff agrees it is broader, but wonders whether there is a better spot; perhaps Section 16304? Or the general duties of trustees?

Peter L. Muhs of San Francisco (Exhibit 14) points out that under this section an income beneficiary would receive double compensation, since the income beneficiary would receive both any income on the unpaid distribution plus statutory interest. The staff believes that this is a good point; the statute should require interest to be offset by any income in the case of an income beneficiary.

State Bar Executive Committee (Exhibit 12) believes there are numerous questions raised by this section, including when is a distribution due and whether the provision would result in taxable income. The Committee suggests that the provision be the subject of

further study and offers its assistance. The staff is not opposed to further study--we want it to be right. However, what time-frame are they thinking of? Shall we include the provision in the current legislation and amend in any revisions we come up with after further study?

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 (application of chapter) without substantive change.

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

Comment. Former Section 661 is superseded by Section 16304(a) (when right to interest accrues; apportionment of income).

§ 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) (income earned during administration of decedent's estate).

§ 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.

JEROME SAPIRO
ATTORNEY AT LAW
SUTTER PLAZA, SUITE 605
1388 SUTTER STREET
SAN FRANCISCO, CA. 94109-5416
(415) 928-1515

September 29, 1987

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA, 94303

Re: L-1024
Interest and Income Accuring
During Administration
Tentative Rec., Sept. 1987

Hon. Commission Members:

Concerning the above-mentioned tentative recommendation, I make the following comments:

1. §12001-Rate of Interest. I do not like the tie-in with minimum interest on Series EE bonds. EE bonds can go out of existence and be replaced by another type. The current indicated yield would be too low, and considerably lower than the provision for 3% below the interest rate on judgments. A higher rate of interest may be an inducement to strive for earlier distribution. A personal representative should not be able to delay distribution, collect higher interest for the estate, and pay less to the distributee.

2. §12002-Income and expenses of specific devises. This appears to require some clarification. Subdivision (c) should provide that deficiencies relating to obligations, expenses and taxes on the property devised, if they are incurred or become due within one (1) year after the date of testator's death, should be paid by the personal representative and the estate, and that the personal representative cannot defer or delay payment of such deficiencies until a date over one (1) year after testator's death and thereby foist the burden of same upon the share of the devisee.

3. Your request for comments as to §12003(b). I recognize that this is a difficult problem to address in all-covering legislation. Your proposal is simple and understandable, but may not cover all bases. Perhaps you should consider including a statement that the recipient of a general pecuniary devise that is a marital deduction gift is entitled to all income therefrom from the date of testator's death. This includes its pro rata share of interest earned thereon from the date of death until distribution. If such interest earned thereon is higher than interest calculated at the statutory rate, the higher amount should be paid or credited to the recipient. If no interest is earned thereon or if the interest earned is less than that calculated at the statutory rate, the devise should bear interest from the date of the testator's death at the statutory rate.

Thanks against for allowing me to participate.

Sincerely,

Jerome Sapiro

Jerome Sapiro

JS:mes

ROBERT K. MAIZE, JR.
A PROFESSIONAL LAW CORPORATION

1604 FOURTH STREET
POST OFFICE BOX 11648
SANTA ROSA, CALIFORNIA 95406
(707) 544-4462

October 1, 1987

California Law Revision Commission
4000 Middlefield Road, Ste. D-2
Palo Alto, CA 94303-4739

Re: Interest and Income Accruing
During Administration

Gentlemen:

I have reviewed your tentative recommendations identified above and have the following comment regarding trusts.

In regards to paying interest on trust distributions there are times when the division of a trust into shares or the distribution of a portion or all of a trust has to be delayed in order to settle questions regarding liabilities of the trust estate and the trustees. The particular liability that I deal with most often is estate taxes.

If a personal representative is not appointed in a probate proceeding, which is customarily the way I structure the estate plan when using a revocable inter vivos trust, the trustee is considered an "executor" under the Internal Revenue Code with the requirement to prepare and file an estate tax return and pay the tax. The trustee does need some time to determine the tax liability, pay the tax, and obtain a discharge of the "executor."

Therefore, I think the provision needs to include some time for the trustee to handle necessary administrative matters before the requirement to pay interest should be imposed.

Very truly yours,

ROBERT K. MAIZE, JR.,
A Professional Law Corporation

by:
Robert K. Maize, Jr.

RKM:jas

Everett Houser
Attorney at Law
5199 E. Pacific Coast Highway #508
Long Beach, Calif. 90804-3307
(213) 498-3955

Oct. 1, 1987

California Law Revision Commission
4000 Middlefield Road
Palo Alto, CA 94303

Re: Tentative Recs Probate Law and Peocedure

The following comments relate to your release of September 1987 marked L-1024.

Page 2 - Marital Deduction Gift and Note 4.

The method of computation becomes technical. Better to fix the return some other way.

Pg 5 - 6154b - A valuable addition.

Pg 7 - 12001. Same objection as to page 2 above. I will "buy" legal rate less 3%.

Pg 7 12002 - I like this section.

Pg 10 - 12006 - Needs clarification to show "old" reference will govern if there is a conflict.

Very truly yours,

Everett Houser

HOFFMAN
SABBAN &
BRUCKER
LAWYERS
10880 Wilshire
Boulevard
Suite 1200
Los Angeles
California 90024
(213) 470-6010
FAX (213) 470-6735

October 1, 1987

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Ladies and Gentlemen:

I am writing with regard to the Tentative Recommendation relating to Probate Law and Procedure - Interest and Income Accruing During Administration, No. L-1024.

Expenses on Property Specifically Devised.

As with most areas of probate law, any rule is subject to abuse. If the specific devisee is different than the residuary beneficiary, then current law encourages a specific devisee to oppose the distribution of non- (or low) income producing property for as long as possible. For example, the specific devisee might also be serving as executor, and deliberately "drag his heels" and make no effort to make a preliminary distribution of the property.

On the other hand, changing the law in the manner which you have suggested could result in abuses in the future. Assume, for example, that the specific devisee is not the executor. The specific devisee of non-income producing property might well wish to have the property sold, or to have the property distributed pursuant to a preliminary distribution, but be thwarted because of "foot dragging" by the executor, or because of the pendency of a will contest. The new rule would nevertheless penalize the specific devisee.

It might well be preferable to give the court some discretion in order to penalize a beneficiary who contributes to a delay in the closing of the estate, where the general rule would otherwise produce a benefit to that beneficiary. Also, the court might be directed to take into account any increase or decrease in value of the property during the period of administration.

HOFFMAN
SABBAN &
BRUCKER
LAWYERS

Rated Interest on Unpaid Devises.

I concur that a variable interest rate would be preferable to the fixed rate provided for under the current statute. I strongly recommend, however, that you not use the rate contained in the Tentative Recommendation. Contrary to your assertion, it would be difficult for practitioners to know the Series EE minimum rate (since it is not widely published) and the percentage is not a simple rounded number. I would suggest, instead, that you use a rate published by the Internal Revenue Service, such as the interest rate on income tax refunds, or the imputed interest rate provided for under Section 7872. These rates are changed every six months, and are easy for practitioners to determine.

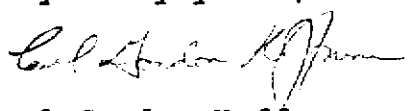
Marital Deduction Gift.

Almost without exception, testators wish to avoid paying tax at the death of the first spouse to die. I have routinely included a clause in wills which I have drafted, requiring the payment of interest on pecuniary marital deduction gifts. Accordingly, I endorse the proposed change.

Interest on Trust Distributions.

I strongly support any and all efforts to reduce the differences between the probate rules applicable to estates, and the rules governing the administration of living trusts. I would urge you to move beyond this limited proposal, and incorporate into the law of revocable trusts such items as a pretermitted heir statute.

Very truly yours,



Paul Gordon Hoffman

PGH12/bn

WILBUR L. COATS
ATTORNEY AND COUNSELOR AT LAW

TELEPHONE (619) 748-6512

October 5, 1987

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, Ca 94303-4739

In re Recommendation relating to Probate Law

Gentlemen:

Reference is made to #L-1024, September 1987.

Comments pertain to Rate of Interest on Upaid Devises.
Section 12003 Interest on general pecuniary devises.

The present Ten per cent (10%) per annum on specific pecuniary devises encourages the executor/administrator w.w.a., to make the distribution prior to one year following death. If necessary request can be made to make the distribution by way of a preliminary distribution order.

The present system in effect places a "penalty" by forcing the executor/administrator w.w.a., to make the distribution if sufficient assets are available to pay creditor claims and estimated administration expenses and to make the distribution of a pecuniary devise.

Reducing the rate of interest that will be easily obtainable by the estate reduces the pressure on the personal representative to pay pecuniary devises prior to the closing of the estate.

It has been my experience that the Probate Court places emphasis on getting distributions out as early as possible. It seems to me by lessening the interest rate on pecuniary devises less emphasis will be placed on getting money distributions out to the beneficiaries.

I suggest the present Ten percent (10%) remain with a provision that the court may reduce it to a lesser interest as suggested in your tenative proposal if the court finds good reason to pay the lesser interest.

Very truly yours,

Wilbur L. Coats

Wilbur L. Coats

12759 Poway Road, Suite 104, Poway, California 92064

LAW OFFICES OF

MORRISON & FOERSTER

LOS ANGELES
WOODLAND HILLS
WALNUT CREEK
PALO ALTO

CALIFORNIA CENTER
345 CALIFORNIA STREET
SAN FRANCISCO, CALIFORNIA 94104-2105
TELEPHONE (415) 434-7000
TELEFACSIMILE (415) 434-7522
TELEX 34-0154

WASHINGTON, D. C.
DENVER
LONDON
HONG KONG

WRITER'S DIRECT DIAL NUMBER

(415) 434-7035

October 6, 1987

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Attention: Nathaniel Sterling
Assistant Executive Secretary

Re: L-1024 (Tentative Recommendation Relating to Interest and Income Accruing During Administration)

Dear Nat:

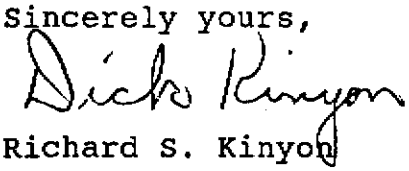
Enclosed are copies of pages 5, 8, 9, and 11-13 of the above-referenced recommendation, dated 9/17/87, showing my recommended changes in the statutory language. I continue to feel very strongly that there should be no difference in the interest payable on general pecuniary devises, whether qualifying as a marital deduction gift or not. The reason given for a special rule for a marital deduction gift, on page 2 of the tentative recommendation, is fallacious. The typical formula marital deduction clause is self-adjusting, and if the Internal Revenue Service should ever decide to discount a formula marital deduction devise because of the one year delay in interest payable on it (which to my knowledge the IRS has never done), a formula clause would increase the amount of the devise automatically to compensate for the discount. Although a non-formula marital deduction devise would not be so adjusted, presumably in that case the testator is not attempting to zero out the tax, and a relatively insignificant reduction in the value of the marital deduction gift would not be a problem. The main problem with Section 12003(b) is that in large estates the marital deduction gift may be such a large percentage of the initial value of the trust out of which it is to be satisfied that the interest on it would exceed the income from the trust, resulting in taxable income to the surviving spouse without a fully usable corresponding deduction to the trust, which would be both a tax disadvantage and require invasion of the remaining trust principal to satisfy the interest obligation.

I have suggested an alternative to Section 12004(b) because I do not understand what the provision on page 9 means. If it means the same as my suggested alternative pencilled in at the bottom of that page, I think it should be restated to make that clear. If it means something else, I would be interested to know what it does mean. In any event, the words "or income" should be eliminated from Subdivision (b), as they are a holdover from a previous version of that subdivision that included trust income commencing at the testator's death, which has been transferred to proposed new Section 16314.

With regard to proposed new Section 16314, the reference to Section 12001 is inappropriate because that section discusses interest on a bond purchased one year after the date of the "decedent's death," and the date when a trust distribution is payable may or may not be the date of anyone's death. Furthermore, it seems to me that a similar one-year rule should apply to general pecuniary distributions from a trust the same as general pecuniary devises, particularly if the trust is a typical revocable trust that becomes irrevocable upon the settlor's death. Otherwise, we would have the unfortunate circumstance of a difference in the rights of a general pecuniary beneficiary depending on whether the settlor had utilized an estate plan involving a revocable trust as opposed to a will.

Finally, although I am glad to see the inclusion of the last sentence of proposed Section 16314 added to the Code, it seems to me that this sentence should be placed elsewhere in Division 9, as it does not relate to interest on trust distributions.

Sincerely yours,



Richard S. Kinyon

RSK:pmd
Enclosure

cc: Prof. Edward C. Halbach, Jr. (w/enclosure)
William V. Schmidt, Esq. (w/enclosure)

A73690[RSK1]

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

SEC. . 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 pecuniary 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, 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).

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).

The first sentence of subdivision (c) is 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). The second sentence of subdivision (c) limits the burden on the estate to the first year after the decedent's death. Expenses paid out by the estate after the first year are ultimately borne by the distributee of the property. The equitable lien imposed by subdivision (c) 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 within one year after the testator's death, the devise bears interest thereafter.

~~(b) A general pecuniary device, 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. ~~Where the will makes a marital deduction gift,~~ subdivision (b) provides ~~that~~ interest runs from the date of the ~~testator's death.~~ The rule of Section 12003 applies where the intention of the testator is not indicated by the will. Section 12000 (application of chapter).

CROSS-REFERENCES

Definitions
  Devise § 32
  Trust § 82
Rate of interest § 12001

NOTE. THE LAW REVISION COMMISSION PARTICULARLY SOLICITS COMMENTS CONCERNING THE WISDOM OF SUBDIVISION (b).

§ 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) An annuitant or a devisee of a devise for maintenance is entitled to interest on the amount of any unpaid accumulations of the payments ~~as income~~ held by the personal representative on each anniversary of the testator'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

§ 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.

* Alternative § 12004(b): "(b) If an annuity is not paid at the end of the specified period, it bears interest thereafter, but no interest accrues during the first year after the testator's death."

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 income ~~payments~~ ~~actually~~ paid to the income beneficiary or received by ~~in the hands of~~ the trustee ~~for payment to the income beneficiary~~ before such termination belongs 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. (a) 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 within one year after ~~on the date when~~ the distribution is payable, the amount of the distribution bears interest thereafter at the minimum rate that would be payable on a Series EE United States Savings Bond purchased one year after the distribution is payable and held to maturity. If there is no minimum . . . distribution is payable.

(b) The rate of interest . . . distribution is payable and shall not be recomputed . . . . [Cf. § 12001]

~~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).

*The last sentence of Section 16314 should be in another section. It is related to but different from the requirement to pay interest on a trust distribution generally.

ZETTERBERG & PERSIMMON
ATTORNEYS AT LAW
319 HARVARD AVENUE
CLAREMONT, CALIFORNIA 91711

STEPHEN I. ZETTERBERG
FUNGLAN PERSIMMON

TELEPHONE
(714) 621-2971

October 7, 1986

OCT 08 1987
RECEIVED

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Interest and income accruing during administration

Dear Members of the Law Review Commission:

First, anent page one of your tentative recommendation dated 09/17/87, Rate of Interest on Unpaid Devises, it does seem fair to reduce the penalty on overdue periodic payments below ten percent. Income on funds held during administration is apt to be lower on income that an owner, freed from estate investment restrictions, could make.

However, keying to a specific series of United States Savings Bonds purchased at a specific time seems too complex. What if there are no Series EE bonds? What if there are differences in interpretation of the application of the Series EE provision? I like the simpler provision in the last part of proposed section 12001(a), which simply keys the rate of interest at three percent below the legal rate on judgments. This is easy to understand, and cannot be all that unfair. Furthermore, keying to judgments (which would produce seven percent) is, as you point out, higher than the current EE rate, and could given an incentive to the estate either to distribute or to invest at seven percent.

Second, I question the necessity for making a special rule under Marital Deduction Gift (page two of your tentative recommendation). Where we have a choice, we should go the simpler route. I can see involved letters of explanation to legatees describing the difference between a general pecuniary device and a general pecuniary device applied under a marital deduction formula clause. This formula clause is aimed at a particular state of the arts in estate tax reduction. Is it wise to construct specific laws aimed at helping a specific kind of estate planning which may or may not be applicable during the expected or probable life of the law?

Perhaps a simpler way would be to provide that if an executor sequesters funds to be used to pay a general pecuniary device, the income from such funds shall be

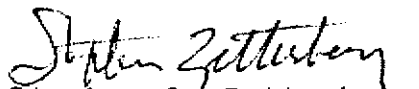
distributed to the devisee. Would not this make it possible for the fiduciary to obtain the marital deduction without the complexity of keying to formula tax provisions?

Incidentally, I was in Superior Court recently when a lawyer, faced with probate notes requiring interest to be paid to a devisee, stated that the Bar Association said that all interest on funds held for clients was to be paid to the State Bar - and his executor was, on this argument, relieved from paying interest!

Other than the above, your interest and income proposals seem appropriate.

Very truly yours,

ZETTERBERG & PERSIMMON



Stephen I. Zetterberg

SIZ:ba

HENRY ANGERBAUER, CPA
4401 WILLOW GLEN CT.
CONCORD, CA 94521

10/9/87

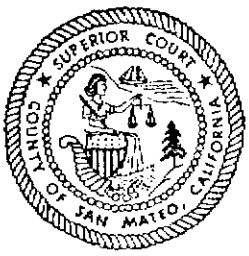
Law Revision Commission

Here are my comments on your tentative recommendation for interest and income accruing during administration.

With respect to the marital deduction income should accrue thereon from the date of death, otherwise the marital bequest may be disallowed. The regulations indicate payment of income from the bequest may not be delayed except for a reasonable time during administration and all the income must be paid to the surviving spouse. This is true under a power of appointment trust as well as a QTIP bequest. over

I agree with your conclusions and recommendations
Suggest they be implemented into law

Henry Angelbeck CPA



Harlan K. Veal
Judge

In Chambers
Hall of Justice
Redwood City, California 94063

November 2, 1987

State of California
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Tentative Recommendation - Probate Code -
Accruing Interest and Income During Administration

Gentlemen:

Please be advised that our Court has reviewed your proposals of September and respond thereto as follows:

It is the consensus of our Court that all but one of the proposed amendments were reasonable. The disturbing amendment is that to Probate Code Section 16304.

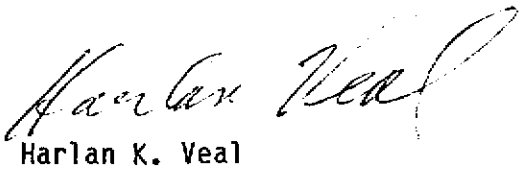
The Code presently provides that if a testamentary trust is silent as to when an income beneficiary is to begin to receive the income, such beneficiary is entitled to receive it from the date the property becomes subject to the trust. Property becomes subject to such trust as of the date of death of the decedent, even though there is an intervening period of administration of the decedent's estate. The proposed amendment provides that if distribution is not made on the date when it is payable (the date of death of the decedent), the amount of the distribution bears interest from such date.

The problem we foresee is that even though a beneficiary to a testamentary trust is entitled to such income from the trust at the date of death of the decedent, in many cases testamentary trusts are not funded until one year or more after the decedent's death. Therefore there is no income to distribute during such time. Further, it is not reasonable to assume that during the period of administration all assets can be appropriately invested to produce not only income, but income on income. In most other situations, when specific assets carry income earned on them out to the distributee, there is no right to produce interest on that income until one year after the date of death. The same should be

true for distributions to a trust.

In addition, since a testamentary trust is not funded or able to produce income at the date of death of the decedent, it seems inequitable to accrue interest from such date. It is this Court's position that if distribution of income is to be made from assets not yet distributed to the trust, one should have a full year to pay income to such beneficiary and as a result interest should not start accruing on such undistributed income until one year after the date of the decedent's death.

Yours very truly,



Harlan K. Veal

HKV:jc
cc: Hon. Thomas M. Jenkins
Judge

JOHN H. PITTS
ATTORNEY AT LAW
1400 NORTH HARBOR BOULEVARD, SUITE 601
POST OFFICE BOX 5100
FULLERTON, CALIFORNIA 92635-0100
(714) 879-5300 OR (213) 691-4726

October 12, 1987

California Law Revision Commission
4000 Middlefield Road
Suite D-2
Palo Alto, CA 94303-4739

RE: Tentative Recommendation - Interest and Income accruing during administration

Gentlemen:

I have reviewed your September 1987 Tentative Recommendation referred to above and would like to make the following comments:

(1) If would be my recommendation that proposed Section 12001 (a) provide that the rate of interest be 3% less than the legal rate on judgements in effect one year after the date of the decedent's death. If a probate estate is held up by reason of litigation or other complications, it might be difficult for the personal representative or the attorney to determine what the minimum rate on series EE United States Savings Bonds was one year after the date of the decedent's death. The fact that the Legislature increased the interest rate from 4% to the legal judgement rate some years ago indicates that the Legislature is sensitive to the flucuation of interest rates. A figure 3% less than the judgement rate is easily determinied from resources within the average law office.

(2) I would question whether paragraph (b) of proposed new section 12003 is necessary. As Mr. Halstead, in his article, points out, the Regs interpreting Q-tip elections anticipate that interest will not be paid on Q-tip property but the income may be used for general administration purposes. His concern is the estate which is held open for an unduly long time. Subsection (a) section 12003 would cure that problem.

Yours truly,

John H. Pitts

John H. Pitts
alp

cc: Schmidt, & Rutan & Tucker

ABBITT & BENNETT
A PROFESSIONAL CORPORATION
SUITE 1100
12121 WILSHIRE BOULEVARD
LOS ANGELES, CALIFORNIA 90025

AREA CODE 213
824-0471

FAX 213 820-5960

DIANE ABBITT
ROBERTA BENNETT*
MARK E. LEHMAN
MITCHELL A. JACOBS*
JEFFREY G. GIBSON
KARYN S. BRYSON
MARIELLEN YARC

OF COUNSEL
KENNETH G. PETRULIS

*CERTIFIED FAMILY LAW SPECIALIST

October 8, 1987

California Law Revision Commission
4000 Middlefield Road, No. D2
Palo Alto, CA 94303-4739

Re: Study L-1024
Interest and Income Accruing During Administration

Commissioners:

Section 120003: Interest on pecuniary devises. The Commission has solicited comments concerning the accrual of interest on the marital deduction amount under a formula clause. We first note that there is some confusion of terms. The code section refers to a general pecuniary devise. We question whether a general pecuniary devise under a formula clause, which is intended to be satisfied in kind, should be treated the same as a general pecuniary bequest of a cash amount.

For example, California Will Drafting Practice, CEB 1982, at § 8.64, p. 370, refers to pecuniary legacies as gifts of specific amounts of cash. In contrast, the marital deduction under a formula clause results in a pecuniary amount to be satisfied: "with assets selected by the trustee from the trust estate that qualify for the marital deduction for federal estate tax purposes. The assets so allocated in kind shall be deemed to satisfy the marital deduction amount on the basis of their value at the date or dates of distribution to trust A."

This definition, which is typical of a marital formula clause, and is used in § 6.37 of California Will Drafting Practice, indicates first that the pecuniary amount is to be satisfied in kind and, second, that the value of the assets to be used are to be valued at the date of distribution to the trust. In the first instance, the proposed statute refers to interest on the pecuniary devise. It is submitted that this contemplates a pecuniary cash devise. In this context, the concept of interest makes sense. Where a pecuniary amount is being satisfied in kind, as it usually is under a formula clause, the concept of interest does not make any sense.

In the second instance, the typical marital deduction formula clause makes clear that distribution values are to be determined as of the date of distribution. The reason for this is to maximize the amount of the taxable estate passing tax free in the credit or by-pass trust. We, therefore, feel that the problem could be solved by defining general pecuniary devise to

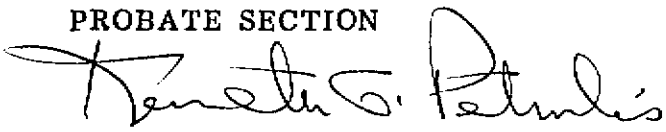
make it clear that it refers only to stated cash amounts, and not to amounts which may be satisfied, wholly or partly, in kind.

It should also be kept in mind that a general pecuniary bequest of cash, e.g., $600,000, into the credit or by-pass trust ideally should bear interest from the date of death, so that the maximum amount is included in the by-pass or credit trust. And, to the contrary, a general pecuniary devise of any amount to be satisfied in kind, and intended to qualify for the marital deduction, should not bear interest until the date designated in the trust instrument. As set forth above, a typical clause would value the assets distributed as of the date of distribution, implying that there is no interest until the date of distribution.

We therefore suggest the section apply only to stated cash amounts and that otherwise no interest accrues except as expressed by the testator.

Yours very truly,

LEGISTIVE COMMITTEE
BEVERLY HILLS BAR ASSOCIATION
PROBATE SECTION



KENNETH G. PETRULIS, Chairman

KGP/ar

cc: James J. Stewart
Melinda J. Tooch
Marc B. Hankins
Ralph Palmieri
Jeffrey A. Altman
David Gutman
Phyllis Cardoza

STANTON AND BALLSUN
A LAW CORPORATION
TELEX/FAX (213) 474-1246
AVCO CENTER, SIXTH FLOOR
10880 WILSHIRE BOULEVARD
LOS ANGELES, CALIFORNIA 90024-4518
(213) 474-5257
PLEASE REFER TO FILE NO.

TEAM4003.03L

October 21, 1987

By Fax and Mail Delivery

James Quillinan, Esq.
444 Castro Street, #900
Mountain View, CA 94041

Re: Tentative Recommendation Relating to Probate Law and Procedure - Interest and Income Accruing During Administration

Dear Jim:

On October 17, 1987, the Executive Committee of Estate Planning, Trust and Probate Law Section of the State Bar of California discussed the State of California Law Revision Commission's Tentative Recommendation Relating to Interest and Income Accruing During Administration.

The Committee thoroughly reviewed each of the major proposals of the Tentative Recommendation; the positions and comments of the Executive Committee are as follows:

1. Expenses on Property Specifically Devised.

The Committee approved the proposed change which provides that expenses upon specifically devised property (except when the property produces income, or when the property is occupied rent-free) are to be charged against the estate for a one-year period commencing with the decedent's date of death. Most of the members of the Committee felt that the proposed changes represented a fair and equitable compromise of the issue of who should bear the expenses for specifically devised property. On the other hand, a few members strongly felt that such expenses should be borne entirely by the specific devisee (the residue should bear none of the burden). This view is well-expressed in the October 9, 1987 letter of William Hoisington which is enclosed with this letter as Exhibit A.

2. Rate of Interest on Unpaid Devises.

The Committee discussed the rate of interest which should be paid on a general pecuniary bequest. The Committee agreed that a more realistic, interest-sensitive rate should be charged. The federal discount rate as well as the Series EE bond rate were discussed. After thorough consideration, the Committee agreed that the rate should be the "charge on loans to depository institutions by the New York Federal Reserve Bank (the "Discount Rate"). William Hoisington discusses the use of the Discount Rate on page 5 of his October 9, 1987 letter.

3. Marital Deduction Gift.

The Committee discussed the importance of conforming California law respecting the computation of marital deduction formula bequests to the regulations promulgated under Section 2056 of the Internal Revenue Code of 1986. The Committee agreed with the proposed change that a general pecuniary devise intended to qualify for the marital deduction should bear interest from the date of the decedent's death. However, the Committee disagreed with the portion of William Hoisington's letter where he states that a charitable deduction also should bear interest from the date of the testator's death.

4. Interest on Trust Distributions.

The Committee spent a considerable amount of time discussing this proposal. Numerous questions were raised including: 1) when is a distribution due; and 2) would the provision result in taxable income even though none otherwise would exist? Therefore, the Committee respectfully suggests that this provision be made the subject of further study; and the Committee offers its assistance.

5. Interest on General Pecuniary Devise.

Although not a part of the Tentative Recommendation, the Committee felt that the concept discussed below is of sufficient merit to request that the Commission undertake a more extensive analysis of the issue and of Mr. Hoisington's proposed solution. His proposal is that a general pecuniary devise should be given the right to receive the lesser of: 1) his/her pro rata share of income actually earned by the executor; or 2) interest at a stated or determinable rate. Mr. Hoisington's proposal is

located on pages 5 through 8 of his October 9, 1987 letter. The Committee respectfully requests that the Commission carefully study the proposal.

Thank you for your consideration.

Cordially,

Kathryn A. Ballsun

KATHRYN A. BALLSUN
A Member of
STANTON AND BALLSUN
A Law Corporation

KAB/rwm

cc: Harley Spitler, Esq.
Janet Wright, Esq.
William Hoisington, Esq.
James Willett, Esq.
Irv Goldring, Esq.
Jim Devine, Esq.
Keith Bilter, Esq.

LAW OFFICES
ORRICK, HERRINGTON & SUTCLIFFE
600 MONTGOMERY STREET
SAN FRANCISCO, CALIFORNIA 94111
TELEPHONE (415) 392-1122
TELECOPIER (415) 954-3759 TELEX 70-3820

NEW YORK, NEW YORK 10036
1211 AVENUE OF THE AMERICAS
TELEPHONE (212) 704-9660

SAN JOSE, CALIFORNIA 95113
55 ALMADEN BOULEVARD
TELEPHONE (408) 298-8800

SACRAMENTO, CALIFORNIA 95814
555 CAPITOL MALL
TELEPHONE (916) 447-9200

LOS ANGELES, CALIFORNIA 90017
444 SOUTH FLOWER STREET
TELEPHONE (213) 624-2470

OCT 13 1987

October 9, 1987

Kathryn A. Ballsun
Avco Center - 6th Flr.
10850 Wilshire Blvd.
Los Angeles, CA 90024

James Willett
555 Capitol Mall
Suite 1050
Sacramento, CA 93814

Harley Spitler
One Maritime Plaza #2000
San Francisco, CA 94111

Janet L. Wright
P. O. Box 1461
Fresno, CA 93716

Bruce S. Ross
333 S. Grand - 38th Flr.
Los Angeles, CA 90071

James V. Quillinan
444 Castro St. - Ste. 900
Mt. View, CA 94041

Re: LRC TR Interest and Income

Gentlepersons:

I missed the October 8th Team 4 conference call on this TR, but got a partial reprieve with Kathy and Harley this morning. Kathy now has my general views on certain perceived problems with the Series EE interest rate, protecting deductiblity in full of general pecuniary legacies intended to qualify for the federal estate tax marital and charitable decuctions by paying interest on those types of general pecuniary bequests from the date of death (even though this may be a nuisance for executors in many cases), and clarifying the lack of significant difference between general pecuniary legacies that are made outright, rather than in trust, in terms of whether or not the executor has any "income" to pay out.

However, I want to add some observations for all of you to consider; and, regardless of what turns out to be the "official" position of Team 4, hopefully, somehow, the substance of these comments will get to the LRC.

Expenses On Property Specifically Devised

Ref. First paragraph of staff explanation (p. 1) and Sec.12002 (p. 7).

I realize that the question is not what the current law is, but rather what the state's policy should be. I happen to think Reichel (copy attached) was correctly decided, even though it seems to be inconsistent with Estate of O'Connor, 200 Cal. 646, 650 (1927) (relevant portion attached). (In this connection, the Comment makes it sound like the entirety of subsection (c) is "consistent" with Reichel. The fact is that this subsection overrules Reichel with respect to taxes and expenses paid prior to one year after death. I think most practitioners who understand what the current state of the law is will view this subsection as providing specific devisees with new rights.)

The only justification I can think of for charging the residuary devisees, rather than the specific devisees, with the costs of keeping the property of the specific devisees in good condition and repair and free of property tax liens during any period of administration is that it is possible that that is what the testator intended. While I can imagine that some testators would, in some cases, intend such a result, my experience regarding the general attitude of testators is clearly to the contrary. Kathy thinks (if I understand her correctly) that many, perhaps most, testators expect that the expenses of maintaining all property in the estate would be borne by the residue -- at least for a reasonable period of time after death. This latter view (with the qualification that 1 year equals reasonable period) is what is reflected in the TR.

In the first place, the "1 year" rule bears no necessary relationship whatever to the testator's probable intent. It is the character of the expense, not the timing of its accrual, that most testators would focus on. For example, suppose the testator dies shortly before a large property assessment is imposed on the specifically devised property. The assessment then falls due and is paid during the first year of administration. Would not most testators, if asked, say that it was only "fair" that the devisee,

rather than the residuary beneficiaries, bear the financial burden of such a large and extraordinary expense. Suppose instead, a specifically devised farm has large expenses not offset by income received prior to distribution. Should the executor delay distribution in order to collect the income and restore the residuary account?

Or, taking the issue perhaps beyond the current status of the case law, what if specifically devised stock in a closely held corporation is acquired within one year after a testator's death by third parties as a result of lengthy and expensive negotiations that result in very substantial compensation being awarded the attorneys for the executor for extraordinary services in effecting the sale of the stock? Would the testator really think that the residuary beneficiaries, who gained no benefit whatever from that transaction, should bear such extraordinary expenses? (What if the transaction had been negotiated but not completed prior to the testator's death, and the attorneys' fees were unpaid at death? Wouldn't the testator expect -- and shouldn't the law require -- that such a debt would be charged against the proceeds of the sale of the stock during administration, even though no income or even capital gain was realized from the sale?)

Imagine the new disputes about whether the expense accrued before or after the one year period. (It certainly cannot matter when the executor finally gets around to paying the bill.) What if the condition or circumstance giving rise to the expense arose during the period, but the resulting expense was not incurred until well after the first anniversary of death. (Executors who are specific devisees may have some real conflicts of interest.)

In any event, it seems to me that, when we do not know what "most testators expect," we should provide a "default" rule that provides basic equity and put the burden on the testator expressly to provide otherwise when he or she wants something else done.

What is the "equitable" rule? Title to all the decedent's property (that specifically devised, as well as

the residue of the estate) passes at the moment of death to those to whom it is devised by the decedent's will. Except for identifying who is entitled to what, the purposes of administration relate solely to the interests of third parties (chiefly, general creditors) and certain family members who are entitled to support (a form of forced heirship). It should be the strong policy of the state to minimize, to the extent consistent with meeting the legitimate objectives of administration, the impact of administration on the rights and obligations of the new owners of the decedent's property. It certainly should not be the policy of the state that, because the interests of others necessitate delay in termination of the powers of the executor (i.e., distribution of the property), the respective rights and obligations of the devisees should change with respect to their property.

If the income derived from certain specifically devised property is insufficient to meet obligations that would be solely those of the specific devisee of such property if the executor had no administrative powers with respect thereto, then the principal of such specifically devised property should be applied to the satisfaction of such obligations -- if they are not otherwise satisfied by advances from the specific devisee.

There is nothing objectionable about the executor being empowered (but not required) to advance the property of the residuary devisees to meet the obligations of a specific devisee with respect to the property of such specific devisee. But, if the executor does so, the residuary devisees should be fully reimbursed by the specific devisee or from the specifically devised property itself -- with compensating market interest.

Therefore, I would strike the words, "To the extent a deficiency paid out of the estate is attributable to the period that commences one year after the testator's death," from proposed Section 12002(c), and start that Section with the words: "The amount paid is ...."

Rate Of Interest On Unpaid Devisees

Ref. Second paragraph of staff explanation (pp. 1-2) and Sec.12001 (p. 7).

The proposal is that the rate of interest on unpaid general pecuniary devises vary on a current basis with the market, rather than being set periodically by the Legislature. I strong agree with the spirit of this proposal, because it is very important that the rate which will be paid out be a rate that the executor can reasonably be expected to earn (net).

While I would prefer that the rate be fixed by statute and changed annually, that appears to be unrealistic. The current 10% rate shows the folly of leaving the adaption of the rate to the Legislature.

Every practitioner I have spoken to about this has recoiled from the EE rate, saying that much too much time would be spent finding out what it is. Harley, Kathy and I talked today about the "short term" "Treasury Rate." I looked for that in the Wall Street Journal and could not find it (unless we are talking about 13 or 26 month Treasury Bills). Unless that is just my ineptitude, while I have no strong feelings about the matter one way or the other, I suggest we go to "the charge on loans to depository institutions by the New York Federal Reserve Bank," which is commonly referred to as the "Discount Rate" and is available in practically every major city paper. It is not a volatile rate and tends to be slightly lower than, and to lag increases in, general market interest rates.

Interest On General Pecuniary Bequests

Ref. Sections 12003 (p. 8). 12). This also bears on Sections 16304 and 16314.

It is felt, I guess, that all general pecuniary devises should bear interest for the same reason that specific devises of property include any income derived from the specifically devised property during administration.

But, with a specific devise, if the property devised earns no income during adminstration, the executor need not pay any income to the devisee -- nor pay any interest in lieu thereof. If the executor is not required to convert specifically devised property that is not income producing into income producing property prior to distribution, why should he or she be required to convert other estate assets into income producing assets simply because the will contains a general pecuniary devise?

It is certainly clear that the executor should not be permitted, by delaying payment of a general pecuniary legacy, to enrich the residuary beneficiaries at the expense of the specific devisee. (As an aside, this is exactly what will happen in many cases as a result of the one year's delay in requiring the payment of interest on non-marital deduction general pecuniary devises. The only arguments I have heard in support of the one year delay are alleged inconvenience to the executor of calculating the interest on the small amounts that are often the subject of general pecuniary devises and the likelihood that the testator did not intend any interest to be paid where the amounts involved are small. Nevertheless, $10,000 paid a year after death is not equivalent to $10,000 at death -- which is the principle underlying the marital and charitable deduction problems. On principle, any compensation for delayed payment should run from death whether or not any federal estate tax deduction is involved. Nevertheless, as I am trying to point out, "compensation for delayed payment" should not be the controlling consideration.)

If, in fact, the executor is earning income on property that may be used to satisfy the general pecuniary devise, then certainly the devisee should share equitably in such income; but that is no reason to require the executor to convert non-income producing property into income-producing property or otherwise to sell estate property in order to obtain cash with which to pay interest in lieu of income. Modern prudent investment practices certainly place no premium on income production rather than capital appreciation; nor should the executor be required to assure that the assets in the estate are appreciating in value -- just because the will contains a general pecuniary devise.

I proposed several months ago that, instead of mandating the payment of interest on all general pecuniary devises, each general pecuniary devisee should be given the right to receive the lesser of a pro rata share of the net income actually earned by the executor or interest at a stated or determinable rate. The reason for this proposal was simply that, in a great many real life situations, the executor may have no way to earn, or otherwise have available, the money necessary to pay the required interest on a large pecuniary bequest without selling property in the estate that the testator and, perhaps even, the interested devisee would prefer not to see sold. (Woe be it to any devisee who delayed more than nine months in disclaiming the right to interest and who might be caught, for income tax purposes, by the "constructive receipt" doctrine in any event.)

In short, I argued that by mandating the payment of interest in all cases, the state would be mandating the sale of non-income producing property in many cases where such sales make no sense at all.

What may not be getting across to the LRC is that many very large pecuniary bequests are intended to be satisfied by distributions in kind, not in cash. Very often, testators word their largest gifts in terms of, "an amount of property equivalent in value to ..." (e.g., one-half my net taxable estate for federal estate tax purposes before any martial or charitable deductions) (which is a general pecuniary legacy), instead of saying: "I give my ranch in Oroville, my residence in Palo Alto and my Syntech stock to ...". Testators do this for the very sound reasons that: they do not know what assets they will own at death, much less what such assets will then be worth, and they want to give their executor wide discretion in choosing what assets, if any, will be sold and, if so, when and under what circumstances. They certainly do not want their executor to be under artificial time pressures to effect any sales that may be desirable.

I suggest a new subsection (c) be added to Section

12003, reading as follows:

"(c) In lieu of paying interest as provided in subdivisions (a) and (b), the personal representative may pay the devisee a pro rata share of the net income of the estate accrued between the date of the testator's death and the date or dates of distribution of the devise."

Interest On Trust Distributions

Ref. Fourth paragraph of staff comments (p. 2), and Sections 16304 and 16314 (pp. 11-12).

If a distribution from an estate to a trust (Section 16304) or from a trust to an income or remainder beneficiary (Section 16314) 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."

It is very difficult to comment on these new provisions (Section 16314 is entirely new) because it is not clear (to me, at least) what assumed inadequacy of the current law being addressed is or, more specifically, what "on the date when the distribution is payable" means. (As I read these sections, this date is the "trigger" for purpose of Section 16304 as well as Section 16314, although it is contained entirely within Section 16314.) I think the idea is that, if a distribution is not made when required to be made, it thereafter bears interest. And, this rule would also apply to unpaid interest.

That is all well and good if (1) there is, in fact, any income earned on the property that should have been distributed earlier and (2) such "post payable date" income would otherwise pass to some other beneficiary. As indicated in my discussion of interest on general pecuniary devises, there are many situations where the estate or trust property is not income producing. Even where this eventually results in "delayed income" being created out post-sale principal, there is no actual additional income being earned out of which the interest could (or even should) be paid.

The last sentence of Section 16314 raises another puzzle where it is suggested that, when a current income beneficiary is not paid at least annually, the delayed payments bear interest. But where would the interest expense be charged? Against the same beneficiary's interest? Certainly there would be no basis for charging the principal account, as it receives no benefit from the delay. (The investment proceeds of previously received and temporarily invested income are income, not principal.)

Insofar as the new interest rule applies to principal distributions, it makes sense only if there is income earned on the assets that would otherwise have been paid out earlier and such income would otherwise benefit another. Very often with income and current principal beneficiary are the same.

Where the rule is applied to final distribution of the residue of an estate or final termination of a trust, it is important only where the persons who would otherwise receive the "post payable date" income or appreciation are different because of the delay. Assuming they are, then the next question is, did the assets in fact earn income or appreciate during the "post payable date" period. This is analogous to what I discussed in connection with the interest on general pecuniary bequests; and I suspect the solution is similar: Give the beneficiary a right to the lesser of interest or a pro rata share of income or (in this case) appreciation.

Note: Section 16314 would be clearer, in any event, if the reference were to "a remainder or principal beneficiary ...."

Sincerely,

Bill

William L. Hoisington

Encl.

RUSSELL G. ALLEN
610 NEWPORT CENTER DRIVE, SUITE 1700
NEWPORT BEACH, CALIFORNIA 92660-6429
TELEPHONE (714) 669-6901 · (213) 669-6901

October 20, 1987

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re September 1987 Tentative Recommendation Relating to Probate Law and Procedure Concerning Interest and Income Accrued During Administration

Dear Ladies and Gentlemen:

To reduce the probability of conflict with the Internal Revenue Service about pecuniary formula marital deduction gifts, I support the enactment of proposed section 12003(b). I suggest, moreover, that it would be appropriate to expand that to include charitable deduction gifts as well as marital deduction gifts -- since conceptually the same problem applies.

Very truly yours,

Russell G. Allen

RGA/br

101 CALIFORNIA STREET
SIXTEENTH FLOOR
SAN FRANCISCO
CALIFORNIA 94111
[415] 433-1900

LAW OFFICES OF
COOPER, WHITE & COOPER

A PARTNERSHIP INCLUDING
PROFESSIONAL CORPORATIONS

TELECOPIER: [415] 433-5530
TELEX: 262877 SCOOP

October 23, 1987

CALIFORNIA LAW REVISION COMMISSION
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re: Tentative Recommendation on Probate Law and Procedure in Line with Interest and Income Accruing During Administration

Gentlemen:

This letter is in response to your request for comment on the captioned tentative recommendation.

With respect to interest on general pecuniary devises which qualify for the marital deduction, I urge you to consider carefully before making any change in current law. Under my most common marital deduction plan, I leave a formula pecuniary marital deduction bequest either outright or in trust for the surviving spouse, usually funded at federal estate tax values with an aggregate value at distribution at least equal to the deduction claimed. Normally I also pass out net income on a proportional basis, although this is not now a concern if the surviving spouse is also the sole beneficiary of all the income of the residuary bypass trust (intended to use up the federal estate and gift tax unified credit).

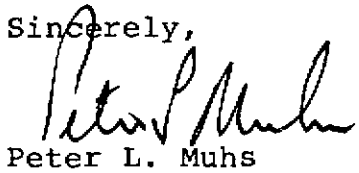
Even if the surviving spouse is the sole current income beneficiary, it is possible that the estate will not earn enough net income to make the interest payment on the marital deduction assets. In this situation, the proposed change would require principal from the tax-sheltered bypass trust to be used to meet the deficiency to the surviving spouse, which would be an undesirable result. I realize your concern not to jeopardize the amount of the federal estate tax marital deduction, but in my practice centered around San Francisco I have not seen an IRS agent make such a challenge. Of course, this does not preclude change in IRS policy which would prompt such challenges.

On a second point, new §16314 could have an unintended result in the event that the beneficiary who has not received probate or trust income is no longer the current income beneficiary of the trust. Suppose, a sum is not paid out to the income beneficiary. Either those funds will produce additional income

or, in the alternative, reduce borrowings of the estate or trust (normally a charge against income), and thereby similarly increasing current income. To the extent that the withheld sum produces income to which the income beneficiary is entitled, but because of death or partial termination on age the income beneficiary is no longer the current beneficiary of the trust assets, the payment of the interest on delayed income will result in a double payment to the income beneficiary. Using as an example $100,000 of withheld income for one year, that might produce $6,000 in additional income to the estate or trust. As long as the beneficiary is still the current income beneficiary, he will receive this $6,000. If on his death, he is also entitled to income at the Series EE rate for the original $100,000 withheld, he will be receiving a double benefit. (If the additional income is charged against his own income share, i.e., assuming the beneficiary remains the current income beneficiary, I suppose there is no harm. However, if the Series EE interest comes out of the next succeeding beneficiary's interest, that beneficiary will pay the first beneficiary interest when the first beneficiary has already, in effect, earned interest on the original sum.) One possible solution would be to apply new §16314 only following demand of the income beneficiary (so that the trustee's withholding of income has an element of wrongfulness to it) or following the termination of a beneficiary's interest in the trust (so the beneficiary is no longer entitled to ordinary current income on the withheld amount).

Thank you for the opportunity to make comments on this tentative recommendation.

Sincerely,



Peter L. Muhs

PLM:jag

WEINBERG, ZIFF & MILLER
ATTORNEYS AT LAW
400 Cambridge Avenue, Suite A
P.O. Box 60700
Palo Alto, California 94306-0700
(415) 329-0851

DAVID C. WEINBERG
HARVEY L. ZIFF
MICHAEL PATIKY MILLER

OF COUNSEL
DAN MUHLFELDER
GRETCHEN O. BURFORD
DAVID G. HARVEY

October 27, 1987

Law Revision Commission
Attn: N. Sterling, Esq.
4000 Middlefield Rd. #D-2
Palo Alto, CA 94303-4739

RE: L-1024 "Interest and Income Accruing During Administration"

Dear Nat:

I have reviewed the above proposal. I think it is a well thought-out change. Although the proposal to charge interest on a marital deduction from date of date is a new concept, it does seem to make sense. However, I would "grandfather" all wills and trusts drafted before the date of enactment to have the previous law apply. Otherwise, results unintended by the drafter will occur.

Feel free to contact me if you want further clarification.

Sincerely,

Mike

Michael Patiky Miller

MPM:lk

RAWLINS COFFMAN
ATTORNEY AT LAW
RED BLUFF, CALIFORNIA 96080

POST OFFICE BOX 158

TELEPHONE 527-2021
AREA CODE 916

October 27, 1987

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Attention: John H. DeMoully
Executive Secretary

Re: Comments on Tentative Recommendation

Dear Mr. DeMoully:

I have TENTATIVE RECOMMENDATION #L-1024.

Because of an extended vacation in New Zealand, I have been unable to review this document adequately.

The language of § 12001 is cumbersome. If the legal rate is ten percent, would not it be reduced by thirty percent rather then by three percent?

I will do better on your next submission.

Very truly yours,

Rawlins Coffman

RAWLINS COFFMAN

RC:mm

LAW OFFICES OF
LEVIN, BALLIN, PLOTKIN, ZIMRING & GOFFIN
A PROFESSIONAL CORPORATION
12650 RIVERSIDE DRIVE
NORTH HOLLYWOOD, CALIFORNIA 91607-3492
(213) 877-0683 · (818) 984-3950

HARMON R. BALLIN
GEORGE M. GOFFIN
GIG KYRIACOU
WILLIAM LEVIN
NANCY O. MARUTANI
JOAN H. OTSU
JAY J. PLOTKIN
STUART D. ZIMRING

OF COUNSEL
MANYA BERTRAM
JUSTIN GRAF

LEGAL ASSISTANTS
PACITA A. FRANCISCO
PATRICIA D. FULLERTON
KIRSTEN HELWEG

October 29, 1987

California Law Revision Commission
4000 Middlefield Road
Suite D-2
Palo Alto, California 94303-4739

Re: Tentative Recommendations Regarding Probate Law and Procedures (Interest and Income)

Gentlemen:

I have reviewed the Tentative Recommendations relating to Interest and Income and have the following comments and suggestions:

1. I support the proposals regarding expenses on specifically devised property.

2. I have always felt that the rate of interest paid on general pecuniary devises was too high for the same reasons you indicate in the proposals. Therefore, I support the reduction of the interest rate.

3. Interest on a marital deduction gift is a more serious matter. I'm not sure that the proposed modification regarding interest on marital deduction gifts does anything more than further complicate the probate code. The fact that the Law might affect certain formula clauses is not, in and of itself, reason to treat them differently. I think this should be thought through more carefully.

4. Likewise, I am not sure a mandatory interest provision is called for in the area of trust distributions. Given the almost infinite drafting possibilities in trust distribution clauses, I think, at the very, least the draftsman should be able to avoid the effect of the proposed code section by specific reference.

As always, it is a pleasure to assist the Commission.

Sincerely,

STUART D. ZIMRING

SDZ:kr

RUSCONI, FOSTER, THOMAS, VAN KEULEN & PIPAL
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW
30 KEYSTONE AVENUE
POST OFFICE BOX 98
MORGAN HILL, CALIFORNIA 95037
(408) 779-2106

ERNEST RUSCONI
J. ROBERT FOSTER
GEORGE P. THOMAS, JR.
CRAIG C. VAN KEULEN
DAVID E. PIPAL
SCOTT D. VAN KEULEN

HOLLISTER OFFICE
150 SAN FELIPE ROAD
POST OFFICE BOX 559
HOLLISTER, CALIFORNIA 95024
(408) 637-8181

November 3, 1987

CALIFORNIA LAW REVISION COMMISSION
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Recommendations concerning interest and income during probate administration

Gentlemen:

I appreciate getting all your proposals relating to the Probate and Trust law, which has had a lot of changes during the past two years. These comments are specifically addressed to the proposed new Probate §12003(b). That provides that a general pecuniary devise that is a marital gift bears interest from the date of the testator's death unless the will or other instrument states otherwise.

I am opposed to this particular subparagraph, since I think it should coincide with subdivision (a), which provides that interest does not start on a general pecuniary devise, including one in trust, until one year after the testator's death. When the will is drafted, the testator already has taken into account the proportional gifts made to spouse and to children or other beneficiaries. I believe it distorts this scheme, when one of the gifts draws interest from one date and the other one from a later date. In other words, this is a trap, although a small one, for all but the most skilled estate planners.

To make my position clear, I think that such a gift should be treated like the gifts stated in subparagraph (a).

Very truly yours,

RUSCONI, FOSTER, THOMAS,
van KEULEN & PIPAL

Ernest Rusconi

ERNEST RUSCONI

ER/bbr