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Note

Trust Depreciation Accounting and
the Minnesota Statute on Accumulations

The Minnesota statutory restriction on income accumulations limits the period for which rents and profits from real property may be accumulated. This Note analyzes whether this statutory restriction prohibits the establishment of depreciation accounts for trusts holding nonbusiness realty. The author concludes that if the settlor did not direct any accumulations or if the "judicious management" exception is applicable, the trustee may establish a trust depreciation account. Nevertheless, the author recommends that the Minnesota statute be repealed.

INTRODUCTION

In order to obtain the advantages of professional management, a testator who wishes to dispose of income-producing real property will often provide for the transfer of this realty to a testamentary trust. Among the advantages which professional management can provide are collections of rent, maintenance of accounts, and preservation of the property's income-producing capabilities.¹ In Minnesota, however, the testamentary trust is denied certain potential advantages of trust management because of statutory restrictions which are imposed on accumulations of "income" received from real property.² For example, the testator's intention may have been

¹. See 2 SCOTT, TRUSTS §§ 170–85 (2d ed. 1956) [hereinafter cited as SCOTT].
². These restrictions are contained in MINN. STAT. § 500.17 (1957), which provides:
   1. Disposal; rules governing. Dispositions of the rents and profits of lands, to accrue and be received at any time subsequent to the execution of the instrument creating such disposition, shall be governed by the rules established in this chapter in relation to future estates in lands.
   2. Accumulation. An accumulation of rents and profits of real estate, for the benefit of one or more persons, may be directed by any will or deed sufficient to pass real estate, as follows:
      (1) If such accumulation is directed to commence on the creation of the estate out of which the rents and profits are to arise, it must be made for the benefit of one or more minors then in being, and terminate at the expiration of their minority;
      (2) If such accumulation is directed to commence at any time subsequent to the creation of the estate out of which the rents and
to provide the trust remainderman with a gift equal to the value of the original assets placed in trust. If the testamentary trust consists of depreciable assets, the testator, as settlor, would normally express this intention by directing the trustee to establish a depreciation account. However, contrary to other areas of trust law which attempt to comply with the settlor's intent, the settlor's direction to establish such an account may be disregarded if the trust assets consist of real property not used in a "going" business because a depreciation account is, in some circumstances, an illegal accumulation.

The purpose of this Note is to determine whether Minnesota's statutory accumulation restrictions should be applied to trusts which consist of nonbusiness realty. The effect of such an application will be analyzed as it relates to the settlor's intent, the income and principal beneficiaries' just expectations, and the public's interest. Finally, the inadequacy and ineffectiveness of the Minne-

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3. Restrictions on accumulation. If, in either of the cases mentioned in subdivision 2, the direction for such accumulation is for a longer time than during the minority of the persons intended to be benefited thereby, it shall be void as to the time beyond such minority, and all directions for the accumulation of the rents and profits of real estate, except such as are herein allowed, shall be void.

5. Ownership in case of valid suspension of the power of alienation. When, in consequence of a valid limitation of an expectant estate, there is a suspension of the power of alienation, or of ownership, during the continuance of which the rents and profits are undisposed of, and no valid direction for their accumulation is given, such rents and profits shall belong to the person presumptively entitled to the next eventual estate.

6. Accumulations of rents and profits of real estate held by trustee. The provisions of this section shall not apply to the accumulations of rents and profits of real estate held or owned by a trustee or trustees of a trust forming a part of a stock bonus, pension, retirement or profit-sharing plan or fund exempt from tax under the provisions of the Internal Revenue Code of the United States, and rents and profits of real estate held or owned by any such trustee or trustees may be accumulated without restriction as to time.

3. 2 Scott §§ 164, 164.1. For an example of how the settlor's intent is disregarded when an accumulations statute intercedes, see Minnesota Loan & Trust Co. v. Douglas, 135 Minn. 413, 161 N.W. 158 (1917).

4. In re Lee, 214 Minn. 448, 9 N.W.2d 245 (1943) (dictum); In re James Trust, 6 Misc. 2d 849, 159 N.Y.S.2d 989 (Sup. Ct. 1957); see Restatement (Second), Trusts § 239 (1959); Niles, Trusts and Administration, 33 N.Y.U.L. Rev. 465, 475 (1958). Contra, Matter of Kaplan, 195 Misc. 132, 88 N.Y.S.2d 851 (Surr. Ct. 1949); see In re Bailey's Trust, 241 Minn. 143, 62 N.W.2d 829 (1954).
sota accumulations statute will be illustrated, and a legislative improvement will be suggested.

I. TRUST ACCOUNTING TERMS AND PRACTICES AS APPLIED TO ACCUMULATIONS PROBLEMS

A. TRUST INCOME

In trust law corpus consists of the property held in trust by the trustee, and income is the return attributable to that property. While this distinction is clear in theory, in practice the determination of what constitutes income and corpus is often very difficult. When questions of income and corpus allocation arise, the usual rule is that the settlor's expressed intent should be ascertained and applied to determine whether specific trust receipts must be allocated to income or to corpus. But despite this general rule, other factors may intervene to prevent the trustee from giving effect to the settlor's intent. For example, if the settlor directs that income is to be accumulated, the trustee may be required to disregard this direction because of statutory restrictions which prohibit certain accumulations.

In analyzing the effect of accumulations restrictions on trust accounting, distributable income must be distinguished from gross receipts. Payments for current maintenance and taxes, and allowances for depletion of wasting assets are allowed as deductions from gross receipts prior to the determination of distributable income. Thus, these payments and allowances are not considered as deductions from income but rather as trust expenses, and the net receipts which remain after these expenses are deducted constitute distributable income. While this distinction between distributable income and gross receipts may appear to be academic because the only effect of these deductions is to charge current income with current expenses, it is relevant in those jurisdictions which restrict trust accumulations. If these deductions were considered to be deductions from income, most accumulations statutes would render

5. See 3 Scott §§ 233, 233.1; Restatement (Second), Trusts § 233 (1959).
6. See Equitable Trust Co. v. Prentice, 250 N.Y. 1, 12, 164 N.E. 723, 725 (1928) (Cardozo, J.).
7. E.g., In re Bailey's Trust, 241 Minn. 143, 62 N.W.2d 829 (1954); 3 Scott §§ 232, 233; see Uniform Principal and Income Act § 2.
them illegal. However, because the statutory restrictions generally proscribe only income accumulations, these deductions are permitted.  

B. DEPRECIATION ACCOUNTS

The objective of a depreciation account is to provide an allowance for any loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy and obsolescence.

While the use of trust depreciation accounts to protect the principal beneficiary from this type of depreciation seems desirable, the courts have taken inconsistent positions as to whether a trust can establish such an account. If the trust consists of nonbusiness realty—that is, assets not used in a “going business”—the courts have held that the deduction is a charge against distributable income rather than gross receipts. As a result, a depreciation deduction, taken by a trust holding nonbusiness realty, may violate the statutory restrictions against accumulations. On the other hand, if the trust realty is part of a “going business,” courts have permitted trusts to create depreciation accounts despite statutory restrictions which prohibit accumulations. This distinction between trusts holding business and nonbusiness assets, however, cannot withstand analysis because the relative interests of the income and principal beneficiaries are identical in both situations.

9. See note 2 supra.
11. Basically, there are two types of depreciation—physical and economic. See authorities cited Note, Depreciation as a Trust Expense, 4 U. Fla. L. Rev. 41, 42 n.2 (1951). Physical depreciation is the loss of an object’s utilitarian value because of wear and tear, whereas economic depreciation is the loss of an object’s market value through all causes. Id. at 42–43. This Note is limited to a discussion of trust accounts established for physical depreciation.
14. Most writers who have criticized the judicial denial of trust depreciation accounts where the trust assets consist of nonbusiness realty suggest that the courts should follow accepted accounting practices. 3 Scott § 239, at 1857; § 239.4; Capron, supra note 13; Huene, Depreciation Charges Against Trust Income, 14 N.Y.U. Intra. L. Rev. 32 (1958); Traver, How
The courts have attempted to support this distinction by pointing to differences between trust and business depreciation adjustments. However, while trust and business adjustments may vary in practice, they are identical in theory. In trust accounting the practice is to actually deduct from the cash account an amount which is transferred to a depreciation reserve fund and adjust the distributable income and depreciation allowance accounts accordingly. These are balance sheet adjustments. Generally accepted business accounting practices, on the other hand, do not provide for the transfer of specific funds to a depreciation reserve fund. Instead, depreciation accounts merely represent a bookkeeping entry. Income is adjusted in order to more accurately reflect the business' net income as shown on the income statement. This adjustment of the income statement affects the balance sheet exactly as the trust accounting adjustments do. The difference which exists in the trust accounting practice is the segregation of assets. But this difference between accepted business practice and trust depreciation accounting practice is, under close analysis, of no consequence as the establishment of a special "fund" has no significance; it too is merely a bookkeeping entry.

C. ACCUMULATIONS

An accumulation has been defined as the withholding of trust income from the income beneficiary and the adding of such income to the trust corpus for the benefit of the principal beneficiary. Obviously, under this definition the income earned by the depreciation sinking fund is not an accumulation because this income is distributed to the income beneficiary. In addition, the depreciation sinking fund itself is, arguably, not an accumulation because the fund retains its identity as income—and it is not distributed for the principal beneficiary's benefit—until it is needed to maintain the value of the corpus. This argument, however, is based only on a semantic distinction; the effect of a trust depreciation account is to deny trust income to the income beneficiary.

Depreciation Affects Distribution of Income from Property Held by Trustee, 85 J. Accountancy 320 (1948); Note, 4 U. Fla. L. Rev. 41 (1951); 55 Mich. L. Rev. 857 (1957). However, some writers have suggested that there really are no "strict" accounting principles. Moonitz & Staehling, Accounting 354 (1952); Isaacs, Principal—Quantum or Res?, 46 Harv. L. Rev. 776, 793 (1933).
15. E.g., In re Bailey's Trust, 241 Minn. 143, 62 N.W.2d 829 (1954).
17. Note, supra note 11, at 44.
Instead, this "income" is ultimately distributed with corpus. Thus, the issue is whether this is an allowable or an illegal accumulation.

1. **Rents and Profits**

A few states, including Minnesota, have limited the application of statutory accumulations restrictions to "rents and profits [received] from real property." However, these statutes do not define what "rents and profits" encompass. Nevertheless, there seems to be little doubt but that these terms are synonymous with "interest and income" as they are applied to personal property. A reasonable interpretation of rents and profits, therefore, would include any money return which a trustee receives from real property. Under this definition, the statutory restriction covers rental returns, lease receipts, and royalty proceeds.

2. **Necessity of Direction**

Despite the inclusiveness of this definition of real property proceeds, this does not mean that any accumulation of these receipts is prohibited. Generally, the statutory restrictions on accumulations do not restrict accumulations per se; instead, only the settlor's *direction* to the trustee to accumulate receipts for either an improper purpose or beyond the legal period is void.

This direction requirement, however, is met, under most interpretations, if adherence to the settlor's direction results in an accumulation of income received from real property. For example, if the settlor directs the trustee to pay a fixed annuity from the income earned by the trust—which consists of real property—the trustee cannot

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20. E.g., Minn. Stat. § 500.17 (1957). Subdivision 3 of this statute reads:

> Restriction on accumulation. If, in either of the cases mentioned in subdivision 2, the direction for such accumulation is for a longer time than during the minority of the persons intended to be benefited thereby, it shall be void as to the time beyond such minority, and all directions for the accumulation of the rents and profits of real estate, except such as are herein allowed, shall be void.

(Emphasis added.)

21. E.g., Hascall v. King, 162 N.Y. 134, 56 N.E. 515 (1900) (payment of mortgage encumbering trust property); Spencer v. Spencer, 38 App. Div. 403, 56 N.Y. Supp. 460 (1899) (residue after an annuity payment); cf. Minnesota Loan & Trust Co. v. Douglas, 135 Minn. 413, 161 N.W. 158 (1917) (50% of trust income to be paid out, 50% to be accumulated).
retain the excess income which is not needed to meet the annuity payments without having made an illegal accumulation. An illegal accumulation also occurs when the settlor directs that trust income is to be used to satisfy a mortgage which encumbers trust property. This raises the question which this Note examines: is the settlor's direction to establish a depreciation account a directed accumulation which is void under the Minnesota statute restricting accumulations?

II. HISTORICAL BASIS OF TRUST ACCUMULATIONS RESTRICTIONS

A. The English Approach—Thellusson’s Will

Prior to 1800, the Rule Against Perpetuities was the only restriction imposed upon accumulations of trust income. As a result, an accumulation of trust income was valid unless it was directed for a period in excess of lives in being plus 21 years. But in 1800 the English Parliament reacted to the holding of the Chancery Court in the now famous case of Thellusson v. Woodford; income accumulations were restricted by statute.

In Thellusson the testator created a testamentary trust in which he directed that the trust's income was to be accumulated for a period equal to the lives of nine of his sons and grandsons living at his death. This disposition was upheld by both the Chancery Court and the House of Lords. In response to this decision, Parliament enacted the Thellusson Act. Parliament feared that if it did not act the "dead hand" would acquire excessive control over wealth, money would become insulated from commerce and taxes,

26. Ibid.
27. 4 Ves. Jr. at 227–30, 31 Eng. Rep. at 117–19. For a general account of the litigation and background to this case, see HARGRAVE, THE THELUSSON ACT (1842); Barry, Mr. Thellusson’s Will, 22 VA. L. REV. 416 (1936).
28. 39 & 40 Geo. III, c. 98 (1800). For a social and economic background to the enactment of this statute, see LUNT, HISTORY OF ENGLAND 593–614 (3d ed. 1947); 8 ENCYC. BRITT. 527–33 (1949).
and the settlor's living heirs would be denied their "natural bounty." 29

The Thellusson Act's solution was quite simple. Accumulations could be directed for only one of four statutory periods: (1) the life of the grantor, (2) 21 years after the grantor's death, (3) the minority of any person alive when the instrument took effect, or (4) the minority of any person who would be entitled to the income if he were an adult. While the original Act has been modified, its basic rules remain the law of England today. 30

B. THE AMERICAN APPROACH

1. Statutory Restrictions

While Parliament enacted the Thellusson Act too late for it to be incorporated into the American common law, 31 the state legislatures first responded to the accumulations problem in 1830 and eventually 15 states had imposed statutory restrictions on accumulations. Of these, three states adopted the English approach; 32 seven states adopted the New York approach which permitted an accumulation if it was for a minor beneficiary during his minority, 33 two states limited accumulations to the period allowed for

29. The most succinct statements supporting enactment of a statute restricting accumulations can be found in the arguments of counsel for the widow and children in Thellusson itself. See 4 Ves. Jr. at 280–81, 31 Eng. Rep. at 143; 4 Kent, Commentaries 286 (14th ed. 1896).

30. The original act was amended by the Accumulations Act, 1892, 55 & 56 Vict., c. 58, re-enacted in the Law of Property Act, 1925, 15 Geo. 5, c. 20, §§ 164–66; see generally 6 American Law of Property § 25.100 (1952).


the suspension of the powers of alienation; and three states adopted restrictions unrelated to other provisions. Despite this wide divergence in the methods which the various legislatures adopted, the main thrust of each of these statutory restrictions was to place reasonable limitations on the period in which trust income could be accumulated.

2. Judicial Limitations—A Developing Common Law

However, the lack of statutory restrictions on accumulations in the majority of states does not mean that settlors in these states can direct unlimited accumulations of trust income. In these states, as well as in states with accumulations statutes, two established property law rules impose partial restriction on accumulations.

First, if the directed accumulation is a condition precedent to the vesting of a gift, the rules limiting the creation of future estates—the Rule Against Perpetuities or the rule against suspension of the power of alienation—will invalidate both the direction to accumulate and the gift of trust corpus. For example, if the testator creates a testamentary trust and directs the trustee to reinvest the trust's income for a period of 30 years (without any reference to lives in being) at which time the trust is to be distributed, the courts will hold that this "offends the rule against perpetuities in that it postpones the vesting... beyond the period limited. Therefore, the whole trust is bad.”

However, even if the gift were to vest in interest within the prescribed period—thus meeting the perpetuities requirement—a second rule is applied. Saunders v. Vautier, an English decision followed by a minority of American courts, provides that the beneficiary of a non-spendthrift trust can prevent the postpone-

34. CAL. CIV. CODE §§ 722-26, 733 (1872); MONT. CIV. CODE §§ 1160-64, 1171 (1895).
35. Alabama restricts trust accumulations where the trust's only purpose is to accumulate income. ALA. CODE, tit. 47, § 146 (1958); see Henderson v. Henderson, 210 Ala. 73, 97 So. 353 (1923). Louisiana limits accumulations to the life of the trust beneficiary through the interaction of two statutes. LA. REV. STAT. §§ 9, 1792-94 (Supp. 1961). Nevada only limits accumulations by spendthrift trusts. NEV. REV. STAT. § 166.150 (1960).
ment of his enjoyment of it if he is *sui juris* and has an indefeasibly vested interest. Together, these two rules effectively limit accumulations of trust income—the outer limits of which, however, can extend beyond the period of perpetuities. But a majority of American jurisdictions have refused to follow the doctrine of *Saunders v. Vautier*. Instead, they have adopted the rule of trust indestructibility enunciated in *Claflin v. Claflin*. That is, if the beneficiary’s interest has vested, the accumulation directed by the settlor may continue unabated for the life of the trust. In these jurisdictions, then, there is no limitation on accumulations of trust income if the beneficiary’s interest is indefeasibly vested unless statutory restrictions are imposed.

But the courts in the jurisdictions following the *Claflin* rule have not permitted unrestrained accumulations. Instead, the courts have developed a new rule limiting accumulations to the period of lives in being plus 21 years. This development of American common law has occurred usually without any awareness by the courts that a new rule was being developed and without any attempt to integrate this rule with other judicial controls on indestructible trusts.

40. For example, if the gift were to vest at the outmost limit in one then an infant, termination would not occur under the *Saunders v. Vautier* rule until the beneficiary reached his majority. For a further explanation, see Cleary, *Indestructible Testamentary Trusts*, 43 YALE L.J. 393, 396 (1934).

41. 149 Mass. 19, 20 N.E. 454 (1889).

42. But if all the beneficiaries are *sui juris* and they agree on a release of the trustee, an extra-judicial transfer of trust property by the trustee to the beneficiaries can be made safely. In theory, a merger has occurred; in practice, because of the principle of estoppel, there is no one to protest the action. See generally 3 Scott § 337.

III. THE MINNESOTA APPROACH

A. Statutory Basis

The Minnesota statute which restricts accumulations of trust income is based upon the New York statute of 1830. While the Minnesota statute, like its model, is very restrictive where it is applied, it only restricts some accumulations of rents and profits received from real property; accumulations of income received from personal property are not restricted. Because they drew this distinction between realty and personalty, the drafters of the Minnesota statute were apparently more concerned with the specific problem of the alienation of real property income than they were with the general problem of the control of wealth.

A valid accumulation of rents and profits received from real estate may be directed by will or by a deed sufficient to pass real property. The statute provides that an accumulation of such “income” is valid if it commences either (1) when the beneficiary of the accumulation is a minor then in being or, (2) if the accumulation commences after the creation of the estate out of which it arises, when the accumulation begins within the time allowed for the vesting of future estates and the future accumulations beneficiary is a minor. In either case the accumulation is valid only as long as the accumulations beneficiary is a minor.

If the direction to accumulate complies with the statutory prerequisites as to time of commencement but it provides for an accumulation beyond the beneficiary’s minority, the accumulation will be void only for the period beyond the minority. Instead of being illegally accumulated, this “income” will be paid to the person presumptively entitled to the next estate—this is usually the income beneficiary. On the other hand, if the accumulation direction is for an invalid purpose—for example, if the in-

44. MINN. STAT. § 500.17 (1957) quoted note 2 supra.
45. See Congdon v. Congdon, 160 Minn. 343, 364–65, 200 N.W. 76, 83–84 (1924); Minnesota Loan & Trust Co. v. Douglas, 135 Minn. 413, 420, 161 N.W. 158, 163 (1917); Fraser, The Rules Against Restraints on Alienation, and Against Suspension of the Absolute Power of Alienation in Minnesota, 9 MINN. L. REV. 314 (1924).
46. MINN. STAT. § 500.17(2)(1) (1957).
47. MINN. STAT. § 500.17(2)(2) (1957).
48. MINN. STAT. § 500.17(2) (1957). The time for vesting of future estates in realty is controlled by MINN. STAT. § 500.13 (1957) and is two lives in being.
49. MINN. STAT. § 500.17(3) (1957).
come beneficiary is an adult—the entire accumulation is void.\textsuperscript{51} Furthermore, in this case the entire trust will fail if the direction to accumulate is an integral part of the trust agreement.\textsuperscript{52}

B. Judicial Interpretations

Although the Minnesota accumulations statute excepts only pension and profit-sharing trusts from its provisions,\textsuperscript{53} the Minnesota Supreme Court has engrafted other exceptions into the statute. For example, the court has found that accumulations by charitable trusts are valid.\textsuperscript{54} The court's rationale in support of this exception is by an analogy to the statutory exemption of charitable trusts from "any statute or rule against perpetuities."\textsuperscript{55} Another exception to the statutory restriction on accumulations seems to have been created by the Minnesota court in \textit{In re Bailey's Trust}.\textsuperscript{56} There, the court appears to have adopted a "judicious management" exception.\textsuperscript{57}

1. \textit{In re Bailey's Trust}

\textit{In re Bailey's Trust}\textsuperscript{58} is the leading Minnesota case interpreting the accumulations statute—especially as it applies to the trustee's establishment of a depreciation account. The testator in \textit{Bailey} created a testamentary trust and transferred his unincorporated nursery business as the trust corpus. The trustees were directed, \textit{inter alia}, to maintain the nursery business, and, in managing the business, they were directed to deduct expenses and other disbursements which they deemed necessary or advantageous before they distributed the net income to the income beneficiaries.\textsuperscript{59} In accordance with these directions, the trustees established a depreciation account for the trust's fixed assets. The income beneficiaries challenged this allocation of gross receipts to the de-

\begin{itemize}
\item \textsuperscript{51} See \textsc{Minn. Stat.} \textsection 500.17(3) (1957).
\item \textsuperscript{52} Minnesota Loan \& Trust Co. v. Douglas, 135 Minn. 413, 161 N.W. 158 (1917), held that a trust would fail if the void accumulation provision contained in the trust agreement was an integral part of the trust.
\item \textsuperscript{53} \textsc{Minn. Stat.} \textsection 500.17(6) (1957). This provision was added by Minn. Laws 1953, ch. 424, \textsection 1.
\item \textsuperscript{54} See City of Canby v. Bank of Canby, 192 Minn. 571, 257 N.W. 520 (1934); \textit{Y.M.C.A. v. Horn}, 120 Minn. 404, 139 N.W. 806 (1913).
\item \textsuperscript{55} \textsc{Minn. Stat.} \textsection 501.12 (1957).
\item \textsuperscript{56} 241 Minn. 143, 62 N.W.2d 829 (1954).
\item \textsuperscript{57} \textit{Id.} at 155, 62 N.W.2d at 837. See 5 \textsc{Powell}, \textsc{Real Property} 846, 850 (1956).
\item \textsuperscript{58} 241 Minn. 143, 62 N.W.2d 829 (1954). In recent litigation concerning the Bailey trust, the Minnesota court refrained from considering accumulation questions raised in the briefs and during oral argument. \textit{In re Bailey's Trust}, No. 129, Minn., Jan. 26, 1962.
\item \textsuperscript{59} 241 Minn. at 147-48, 62 N.W.2d at 833.
\end{itemize}
preciation account because it improperly reduced, in their opinion, the distributable net income.

(a) The Allocation Argument

The beneficiaries' first argument was that the allocation violated the trustees' obligation to deal impartially with successive beneficiaries; that is, the allocation of gross receipts to the depreciation account unfairly favored the remaindersmen over the income beneficiaries. The basis of this argument is the rule of construction that in the absence of a specific direction the settlor is presumed to have intended that all of the trust's income, as defined earlier, will be distributed to the income beneficiaries. This rule of construction is based on an analogy of the trust income beneficiary's status to the status of the legal life tenant. If the law applied to the legal life tenant were adopted in the trust situation, the court would not uphold a trust depreciation account because it favors the ultimate taker over the income beneficiaries. In response to this challenge, the Minnesota court noted that a depreciation deduction is a proper business expense, deductible from gross receipts, according to generally accepted accounting practices. Therefore, the court reasoned, if the trust's assets consist of a "going" business, the trustees should be permitted to establish a depreciation account for fixed assets. However, this reasoning of the court implies the relationship between trust and business accounting; it does not give weight to distinctions between an income beneficiary and the owner of a business. Normally, the business owner is in

60. Id. at 149, 62 N.W.2d at 834.
61. See notes 5–9 supra and accompanying text.
62. The relationship of the legal life tenant and the remainderman is superficially analogous to the life beneficiary-remainderman relationship contemplated by most settlors because the life beneficiary of a trust usually sees the total income of the trust with the corpus of the trust going to the eventual remainderman. See Matter of Davies, 197 Misc. 827, 96 N.Y.S.2d 191 (Surr. Ct.), aff'd, 277 App. Div. 1021, 100 N.Y.S.2d 710 (1950); 3 Scott § 239.3. Scott discusses this analogy in relation to wasting property, but he indicates that buildings should, at times, also be considered such. Id. § 239.4.
64. 241 Minn. at 150, 62 N.W.2d at 834.
the position of both the income beneficiary and the remainderman. As a result, his objective is to accommodate two conflicting interests: (1) a maximum income return and (2) the maintenance of sufficient working capital for business operations. In this situation tax considerations tend to be controlling. On the other hand, the income beneficiaries and the remaindermen were not the same persons in Bailey. Hence, the court’s analogy to generally accepted business accounting practices seems to be inapposite. There is, nevertheless, strong authority for the court’s position where the trust consists of a “going” business.66

(b) The Illegal Accumulation Argument

The income beneficiaries’ other objection to the depreciation allowance was that the account resulted in an illegal accumulation.67 The court could have responded, as it did to the allocation argument, that a depreciation allowance is a proper business expense, and, therefore, it should be treated as a valid deduction from gross receipts rather than as an income deduction.68 Instead, the court relied on dictum in Gerin v. McDonald69 that statutory restrictions on accumulations are not violated if the settlor does not direct the trustee to accumulate income. That is, the court will not find an implied direction to accumulate if the settlor’s directions are ambiguous. While this conclusion is supported by the Minnesota statute,70 the court’s further conclusion that the trustees’ establishment of a depreciation account—because of the settlor’s other directions—will not be interpreted as an implied accumulation seems anomalous. Logically, it would seem that if the settlor’s words can be interpreted to find an implied direction to establish a depreciation account, they also contain an implied direction to accumulate.

2. Trust Depreciation Accounting After Bailey

In dictum appearing in Bailey, the Minnesota court appears to have recognized the “judicious management” doctrine as an ad-

67. 241 Minn. at 154, 62 N.W.2d at 836.
68. This result occurs because the Minnesota statute only prescribes “income” accumulations. If depreciation is a proper business expense, as the court determined, it is not “income” of the business and, therefore, does not come within the limits of the statute.
69. 64 F.2d 394 (8th Cir. 1933).
70. MINN. STAT. § 500.17(3) (1957).
ditional exception to the accumulations statute. This seems clearly implied in the court's comment that "if the accumulations . . . are restricted to the purpose of preserving the corpus and making it more efficient for earning purposes, there is no violation of the statute."71

This exception would seem to apply equally to trusts which consist of either a "going" business or nonbusiness real property. In either case a depreciation account would serve the "purpose of preserving the corpus and making it more efficient for earning purposes." But the court did not indicate how depreciation accounts would be treated under the judicious management exception. The court did not relate its discussion of the judicious management exception to trust depreciation accounting; it also stated that the determination of whether a fund complied with the exception's requirements was a jury question.72

Although the court did not fully explain the scope of the judicious management exception, some conclusions can be drawn as to the effect of Bailey on trust accumulations of real property income. First, the trustee may establish a depreciation account for the fixed assets of a "going" business if the settlor has not prohibited the creation of such an account because a depreciation deduction is an expense deductible from gross receipts rather than from distributable income. Second, a depreciation account is not an illegal accumulation if the settlor has not specifically directed the establishment of the account. Third, even if the settlor specifically directs the establishment of a depreciation account, the court will not hold the accumulation void if it finds that the account is needed for the judicious management of the trust.

In addition, a reasonable interpretation of the Bailey case could conclude that depreciation accounts may be established for trusts which consist of nonbusiness property without violating the statutory restrictions on accumulations. In Bailey the trust consisted of a "going" business; hence, the court's determination that a depreciation deduction is a business expense—not an income deduction—logically foreclosed the court's further discussion of trust depreciation accounts.73 Consequently, the court's discussion of the "direction" requirement and the "judicious management" exception is superfluous unless it applies to trusts which hold nonbusiness property. As a result, the Minnesota court's earlier dictum in In 71. 241 Minn. at 155, 62 N.W.2d at 837. (Emphasis added.)
72. Ibid.
73. With the court's finding that the depreciation account was composed of items that were a proper business expense, the statute would have no further application. See note 68 supra and accompanying text.
that depreciation accounts for trusts which consist of nonbusiness property are invalid, seems to have been implicitly overruled.

IV. RECENT TRENDS IN ACCUMULATIONS RESTRICTIONS

A. STATUTORY TRENDS

In recent years the legislatures have tended to limit or repeal statutory restrictions on accumulations. Three states which originally enacted the English Act have liberalized their rules, and accumulations are allowed for the period allowed by the Rule Against Perpetuities in these states. Of the seven states which adopted statutes on the New York model, two have amended their statutes to allow accumulations for the period allowed by the Rule Against Perpetuities, and two states have repealed their accumulations statutes outright. Furthermore, no state has added to or increased its restrictions on trust accumulations.

B. FACTORS AFFECTING THE STATUTORY TREND

1. Tax Considerations

Accumulations of trust income are directly and indirectly affected by present tax laws. An example of a direct affect is the taxation of distributions of accumulated trust income. However, this tax merely equalizes the trust tax burden with the tax burden carried by nontrust entities. Since the trust is not subject to a special tax burden for the accumulation of trust income, this direct tax is not an effective deterrent. An example of an indirect tax burden is the taxation, in some cases, of transfers of property to a trust. But the coverage of these provisions is not broad enough, the tax rates are not high enough, and the tax loopholes are not narrow enough for such provisions to effectively deter transfers of

74. 214 Minn. 448, 9 N.W.2d 245 (1943).
property in trust—at least when these provisions are compared with the taxation of nontrust transfers.\textsuperscript{50} Since the tax laws do not effectively restrict accumulations of trust income, it would seem that the tax laws do not support the trend to remove accumulations restrictions.

But the tax laws have another influence which has accelerated the trend toward the removal of statutory restrictions on accumulations. States without restrictive accumulations statutes provide their settlors with advantages which are not available to settlors in states which do restrict accumulations. The advantage to the former is that the trust is a separate taxable entity through which the settlor can achieve limited income-splitting.\textsuperscript{81} For example, if the income beneficiary is a high bracket taxpayer, the trust's accumulation of income will result in the imposition of taxes on the trust at a rate substantially lower than the tax rate imposed on the income beneficiary if the trust's income had been distributed directly to him. And, where the trust has paid the taxes imposed on the accumulated income, the beneficiary may not be subject to further taxes when this accumulated income is distributed.\textsuperscript{82} Furthermore, when the trust accumulates income, the taxpayer gains, in effect, an additional exemption which would not be available to him if the trust were distributing current income.\textsuperscript{83} The desire to eliminate this difference in treatment would seem, therefore, to be a very strong reason supporting the legislative trend toward a liberalization of statutory accumulations restrictions.

2. Concepts of Property Control

In addition to the unfavorable tax consequences which a state's accumulations restrictions will create, accumulations statutes also involve an interference by the state with the settlor's ability to control the use of his property after he has transferred it to a trust. The decision to interfere with the settlor's disposition of his property requires the legislature to balance various competing interests.\textsuperscript{84}

The settlor has an interest in being able to direct the use of his property. Trust law generally supports this interest. On the other

\textsuperscript{50} See Waterbury, Some Further Thoughts on Perpetuities Reform, 42 MINN. L. REV. 41, 45 & n.28 (1957).

\textsuperscript{81} CASNER, ESTATE PLANNING 733-42 (3d ed. 1961).

\textsuperscript{82} INT. REV. CODE OF 1954, §§ 667-68. This assumes, of course, that the five-year throwback rule in § 665 has been avoided. See § 665(b)(1)-(4).

\textsuperscript{83} This advantage occurs because both the taxpayer and the trust are granted personal exemptions. INT. REV. CODE OF 1954, §§ 151, 642(b).

\textsuperscript{84} See Congdon v. Congdon, 160 Minn. 343, 362-63, 200 N.W. 76, 83 (1924).
hand, protection of the public interest may require that limits be established within which the settlor may direct how his property will be used. Traditionally, two factors have predominated in support of establishing outer limits on the settlor's discretion. First, trust accumulations are considered undesirable because they remove money and property from commerce. This argument, however, is based on an erroneous fiction; whether the trustee accumulates or distributes the trust income, he is obligated to place all trust funds, including accumulated funds, in profitable and prudent investments. Hence, the accumulated property is not removed from commerce. The second factor is the argument which apparently persuaded Parliament when it passed the Thellusson Act—if unreasonable accumulations are not restricted, excessive wealth will ultimately be under the control of the accumulations recipient. The weakness of this argument is demonstrated by the distribution which occurred under Thellusson's will. At the time of the testator's death, it was estimated that the value of the accumulations provided for by the testamentary trust would exceed £30 million—a sum larger than Great Britain's national debt. But after 36 years, when the distribution occurred, only £326,000 had been added to corpus by the accumulations. In addition, present tax laws would further restrict such accumulations today. The public interest, therefore, does not appear to require the protection afforded by strict restrictions on accumulations of trust income.

3. Ineffectiveness of Accumulations Statutes

When the revisors of the New York statute originally proposed an accumulations statute, it was included as part of a general statutory scheme intended to limit a property owner's ability to suspend the powers of alienation. At that time trusts were considered undesirable by the revisors because they limited the beneficiaries' control over the property. However, the legislative attitude toward trusts has changed, and the restrictive controls placed on

86. 3 SCOTT § 227; 1 BOGERT, TRUSTS § 101 (1951); RESTATEMENT (SECOND), TRUSTS § 227 (1959).
88. LEACH, FUTURE INTERESTS 796–97 (1935); Barry, Mr. Thellusson's Will, 22 VA. L. REV. 416, 424, 425 & n.19 (1936).
90. Fraser, Future Interests, Uses and Trusts in Minnesota, 28 MINN. STAT. ANN. 53, 87 (1947).
trusts have been modified. Furthermore, the statutory restrictions on accumulations of trust income have been ineffective.

For example, the Minnesota statutory restriction has been ineffective because it is limited to rents and profits received from real property and because of judicial interpretations. Thus, in Minnesota the only accumulations limitation on personal property trusts is the common-law Rule Against Perpetuities. On the other hand, the statutory restriction of accumulations derived from real property receipts is easily avoided. If the settlor's real property holdings are significant enough to warrant incorporation, this procedure avoids the statutory restrictions because the "rents and profits" will be received in the form of dividend payments which are personal property. Or, the settlor can direct the trustee to sell the real property transferred in trust; thus, there is an accumulation of income received from personality which is not within the statutory prohibition. The Minnesota court's requirement of a "specific direction," allowance of depreciation accounts for trusts which consist of a "going" business, and adoption of the judicious management exception have also contributed to the ineffectiveness of the Minnesota statute.

V. A PROPOSAL

As the foregoing analysis indicates, alteration of the Minnesota accumulations statute seems to be desirable. The present statute has placed Minnesota settlors in a disadvantageous tax position vis-a-vis settlors in nonrestrictive states; it has been ineffective; and other statutes provide adequate controls over the acquisition of ex-

91. MINN. STAT. § 500.17 (1957). Any question as to whether this statute could be applied to a personal property trust was removed by Congdon v. Congdon, 160 Minn. 343, 200 N.W. 76 (1924); however, a question remains as to the application of the statute to a mixed realty-personalty trust. The Minnesota court has never passed on this question, although it had the opportunity to do so in In re Bailey's Trust, 241 Minn. 143, 62 N.W.2d 829 (1954). In Toms v. Williams, 41 Mich. 552, 2 N.W. 814 (1879), the Michigan court was presented with an accumulation of income by a mixed personalty-realty trust. At that time Michigan had a statute similar to Minnesota's. The Michigan court separated the personalty from the realty and applied the statute to the accumulation from the realty only. See MINN. STAT. § 501.11(6) (1957); Congdon v. Congdon, 160 Minn. 343, 363-65, 200 N.W. 76, 83-84 (1924); Minnesota Loan & Trust Co. v. Douglas, 135 Minn. 413, 423-26, 161 N.W. 158, 163 (1917); Fraser, The Rules Against Restraints on Alienation, and Against Suspension of the Absolute Power of Alienation in Minnesota, 9 MINN. L. REV. 314 (1925).

92. Congdon v. Congdon, 160 Minn. 343, 200 N.W. 76 (1924). See Baldwin v. Canfield, 26 Minn. 43, 1 N.W. 261 (1879) (dividends received from stock investments are personalty).
cessive wealth. Two approaches would seem to be available to the legislature: either the statute should be amended to extend the area and period of permissible accumulations or the statute should be repealed.

New York, for example, recently amended its accumulations statutes to extend substantially the period of accumulation and to allow an accumulation for any purpose.94 Now accumulations are usually allowed if they “terminate at or before the expiration of” the common-law period of perpetuities. This legislative change was probably designed to reverse the “flights of trust business to the greener fields of Connecticut and New Jersey” and to alleviate the “inconveniences inflicted on . . . [those who participated] in these flights.”95 If Minnesota were to adopt this provision, a settlor could validly direct the establishment of a depreciation account for the trust’s fixed assets regardless of whether the real property is part of a “going” business. However, in the context of the present tax laws it is questionable whether any restrictions should be applied to accumulations of trust income.

For example, if the Minnesota statute were repealed, the trustee of a trust holding nonbusiness real property could establish a depreciation account where the settlor so directed. Of course, if, in this situation, the trust instrument is silent, this issue would not be resolved. But this is not an appropriate subject of legislation; instead, it is a judicial question and the answer is dependent upon the settlor’s intent.

94. N.Y. REAL PROP. LAW §§ 42, 61; N.Y. PERS. PROP. LAW §§ 11, 16.