Memorandum 91-73

Subject: Study L-1039.01 - Problem with Interest and Income Statute (Interest and Income on Trust Distributions)

This memorandum considers a technical problem that has been brought to our attention concerning the application of the interest and income rules to trust distributions pursuant to Probate Code Section 16314. This section provides as follows:

> 16314. (a) A specific gift, a general pecuniary gift, an annuity, or a gift for maintenance distributable under a trust carries with it income and bears interest from the date of the settlor's death or other event upon which the distributee's right to receive the gift occurs, in the same manner as a specific devise, a general pecuniary devise, an annuity, or a devise for maintenance under a will set forth in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7.
>
> (b) For the purpose of this section, a reference in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7 to the date of the testator's death means the date of the settlor's death or other event upon which the distributee's right to receive the gift occurs.
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> Comment. Section 16314 restates Section 16314 of the repealed Probate Code with a clarifying change in subdivision (b). *Cf.* Section 21120(b) ("pecuniary gift" defined). The rate of interest payable on trust distributions parallels that payable in probate administration. See Section 12001 (rate of interest). The trust instrument may vary the rules provided in this section. See Section 16302. As to the applicability of Section 16314 to a trust created before July 1, 1989, see Section 16315. As to the application of any amendments made after that date, see Section 3.

Richard S. Kinyon has written concerning some confusion as to the time the right to interest arises. (See letter attached as Exhibit 1.) He notes that some commentators believe that the statute provides different rules for trusts than for estates. He recalls correctly that the trust rules are the same as the estate rules.

Apparently the confusion arises from focusing on the phrase in Section 16314(a) that a trust gift "carries with it income and bears interest from the date of the settlor's death." Although an estate distribution carries with it income from the date of the testator's death, it bears interest beginning one year after the testator's death. In this view, the provision that the gift bears interest in the same manner as a testamentary disposition is not seen as incorporating the one-year delay rule with respect to interest.

Original Recommendation

As originally recommended by the Commission, a different version of Section 16314 adopted the one-year delay rule both in estates and in trusts where the distributee's right arises on the settlor's death. In cases arises because of some other event, a trust distributee would be entitled to interest from the date of the occurrence of the event. As explained in the *Recommendation Relating to Interest and Income During Administration,* 19 Cal. L. Revision Comm'n Reports 1019, 1024 (1988):

> The proposed law parallels the law applicable to probate estate administration: if distribution of a general pecuniary gift from a trust is made when due, the amount of the distribution accrues interest from the date it is due, except in the case of a distribution due on the death of the settlor, in which case interest begins to run one year after death.

March 1988 Revision

The original proposal was part of the Commission's 1988 omnibus probate bill, Assembly Bill 2841 (Harris). After the bill was introduced the Commission made a large number of amendments. At the March 1988 meeting, the Commission adopted a new version of Section 16314 that reflected a different policy. This revised version was eventually enacted and carried forward without substantive change in the new Probate Code.

Thus, the original recommendation no longer expresses the effect of Section 16314.

Policy of Section 16314

The existing section is nearly identical to the language proposed by Dick Kinyon as part of the review of AB 2841 conducted by Team 1 of the Executive Committee of the State Bar Estate Planning, Trust and Probate Law Section. (See Fourth Supplement to Memorandum 88-8, considered at March 1988 meeting.) He explained the policy of Section 16314 as follows:

The effect of this suggested new Section 16314 would be to treat distributions from a trust in the same manner as distributions from an estate, without regard to whether the right to them occurs as the result of the death of the settlor or any other event. This is a change in policy from Section 16314 as set out [in AB 2841 as introduced], which relates only to interest on a general pecuniary gift under a trust and would require that interest be payable from the date when the distribution is payable, except that interest on a distribution payable on the death of the settlor would commence one year after the settlor's death. It seems to me that it would be desirable to give the trustee a one-year grace period within which to pay all pecuniary gifts even if the event giving rise to the gift is not the settlor's death. In many cases such event is the death of a beneficiary (e.g., the surviving spouse) who also may be serving as the trustee, necessitating the qualification of a successor trustee and possibly the payment of federal estate taxes (e.g., with respect to a marital deduction trust), which may make it difficult or impossible for the gift to be distributed soon after the event.

The language adopted at the March 1988 meeting was amended into AB 2841 on April 19, 1988.

Staff Recommendation

The staff proposes to revise Section 16314 to clarify its intent and to state in the Comment that the rules are the same for estates and trusts on this point:

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

16314. (a) A specific gift, a general pecuniary gift, an annuity, or a gift for maintenance distributable under a trust carries with it income and bears interest ~~from the date of the settlor's death or other event upon which the distributee's right to receive the gift occurs,~~ in the same manner as a specific devise, a general pecuniary devise, an annuity, or a devise for maintenance under a will as set forth in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7.

(b) For the purpose of this section, a reference in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7 to the date of the testator's death means the date of the settlor's death or other event upon which the distributee's right to receive the gift occurs.

Comment. Subdivision (a) of Section 16314 is amended to make clear that the policy of this section is to apply to trusts the same rules that apply to estates. Thus, the one-year delay rule applicable to interest on distributions from decedents' estates under Chapter 8 (commencing with

Section 12000) of Part 10 of Division 7 also applies to trust distributions, whether the right to the distribution arises on the settlor's death or on the occurrence of some other event. In effect, this section provides a one-year grace period within which the trustee may pay pecuniary gifts without interest whether or not the event giving rise to the right to distribution is the death of the settlor. The rate of interest payable on trust distributions parallels the rate of interest payable in probate administration. See Section 12001 (rate of interest). The trust instrument may vary the rules provided in this section. See Section 16302.

This amendment is intended as a technical, nonsubstantive clarification of the existing rule and applies to the extent provided in Section 16315 (application to trust created before July 1, 1989). See Section 3(c).

If the Commission approves revision of Section 16314, we would include the amendment in the 1992 probate clean-up bill.

Respectfully submitted,

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Re: Probate Code Section 16314

Dear Nat:

In accordance with our telephone conversation this morning I am writing to suggest a clarifying amendment to the above referenced section to make it clear that a specific gift, general pecuniary gift, annuity, or gift for maintenance that is distributable under a trust will be treated the same as a similar gift under a will. As I mentioned to you during our telephone conversation, a lecturer in a CEB program a year or so ago, as well as the author of an upcoming article in the CEB California Estate Planning, Probate and Trust Law Reporter, have indicated that there is a different rule with respect to trusts than for estates. As you know, I consulted with the Commission in connection with that section, and I am quite certain that our intent was to have the same rule.

I believe the confusion might be avoided by simply changing the words "from the date of" in the third line of subdivision (a) to "following," with a corresponding addition to the Law Revision Commission Comments to the effect that a specific gift, general pecuniary gift, annuity, or gift for maintenance distributed out of a revocable trust that became irrevocable on the death of the settlor is to be treated exactly the same as a similar distribution from an estate. You might even state explicitly that unless otherwise provided in the trust instrument, interest would not begin to accrue until one year after the date of death or other event upon which the distributee's right to receive the gift occurs.

Best regards.

Sincerely yours,

Dick Kinyon

Richard S. Kinyon

RSK:bjs