SCHOOL FUND ... Profits derived from sale of corpus of school fund created under and by virtue of Art.II, Sec. 8 of the Constitution of Missouri must be considered as "increment to principal" as differentiated from "income".

March 3, 1933

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Board of Education of St. Louis, Mo.
St. Louis, Mo.

Gentlemen:

In answer to your oral inquiry of recent date pertaining to the disposition of profits arising from a contemplated sale of certain bonds now held by the Board of Education in the City of St. Louis, Missouri in its permanent school fund, it is our opinion that such profits should be considered as an increment to principal rather than as income and hence should not be transferred to the General Revenue Fund.

Briefly, our reasoning is as follows:

We assume that the fund referred to by you is the fund referred to in Article II, Section 8 of the Constitution of Missouri. That section provides:

> "All moneys, stocks, bonds, lands and other property belonging to a county school fund, also the net proceeds from the sale of estrays, also the clear proceeds of all penalties and forfeitures, and of all fines collected in the several counties for any breach of the penal or military laws of the State, and all moneys which shall be paid by persons as an equivalent for exemption from military duty, shall belong to and be securely invested and sacredly preserved in the several counties as a county public school fund; the income of which fund shall be faithfully appropriated for establishing and maintaining free public schools in the several counties of this state."

Since the City of St. Louis is to be considered as a county under the above section of the Constitution (See Railroad

v. Gildersleeve, 165 Mo. l.c. 379), the answer to your quaere and the test of the sufficiency and correctness of our opinion depends upon the meaning of the word "income" as used in the above quoted section.

We find under the authorities the word "income" as differentiated from "principal" or "capital", has varied meanings depending to a large extent upon the circumstances surrounding its use.

See:

CORPUS JURIS, Vol. 31, page 397;
WORDS AND PHRASES, First Series Vol. 4, page 3501;
WORDS AND PHRASES, Third Series, Vol. 4, page 163.

As used under the income tax laws of the United States and of the several states, the word "income" has been generally defined as "the gain derived from capital, from labor or from both combined, provided it be understood to include profit gained through sale or conversion of capital assets."

See:

EISNER v. MACOMBER, 252 U.S. 189, l.c. 207, 64 Law. Ed. 521, l.c. 528, 40 Sup. Court Rep. 189, cited with approval in MERCHANTS LOAN AND TRUST CO. v. SMIETANKA, 255 U. S. l.c. 578, 65 Law Ed. l.c. 755.

But as shown by the decisions so holding such definitions of income as used in the income tax law depends upon the words used in such laws, such laws being much more explicit than the section of the Missouri Constitution now under consideration.

See:

Chap. 19, Title 26 U. S. C. A., and particularly Sec. 954 thereof.

Many other authorities content themselves by saying that income should be defined as being any material gain or product from

either capital, labor or both.

See:

CONNECTICUT GENERAL LIFE INS. CO. v. CATON, 218 Fed. 188, 205;

GAVIT v. IRWIN, 275 Fed. 643

If either of the above definitions are accepted, it would appear that the contemplated profit under consideration should be considered as income, but whether or not it is to be so considered depends in the last analysis upon the intention of the framers of the Constitution as expressed in the above quoted section.

STATE ex rel HARRY L. HUSSMAN REFINING CO. v. CITY OF ST. LOUIS, 5 S. W. 2nd, 1080;

STATE ex rel ROSEBROUGH MONUMENT CO. v. CITY OF ST. LOUIS, 11 S. W. 2nd, 1010.

We believe that the intention of the framers of the Constitution as expressed in the above section is clear in that it is intended that the fund therein provided for should be permanent as shown by the extremely strong words "shall be securely invested and sacredly preserved, so that the income of such fund could be used for general school purposes forever."

The object to be attained by the above provisions of the Missouri Constitution differs materially from the objects to be attained by the statutes relating to taxes heretofore referred to. The object or objects of the above quoted section of the Missouri Constitution compare favorably with the object a testator has in mind when he leaves a fund in trust, the income of which is to be given to A for life, and the remainder, after A's death to B. In

fact the fund herein considered has been referred to as, and in fact is, a trust fund for the purposes set forth in the Constitution (See Railroad v. Gildersleeve, supra). Therefore we deem the established law relative to testamentary trusts as to what is or is not income as being very pertinent to the question that confronts us here.

We find that in the case of testamentary trusts where the income is given to a person for life with the remainder to another, that the courts have consistently held that profits derived from a sale of part of the trust "res" or "corpus" during the life of the life tenant must be treated as an increment to the corpus or res rather than as income:

> In Re McKEOWNS ESTATE, 363 Pa. 78, 106 A. 189, l.c. 192, it is said: "If a stock is sold which belongs to the principal, ordinarily all of the proceeds thereof also belong to the principal."
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> The Supreme Court of Error for Connecticut, in CARPENTER v. PERKINS, 83 Conn. 11, 74 A. 1062, said in referring to an increase in the value of a fund by reason of a sale of a part of the fund held in trust to pay the income for one for life and on his death to transfer the res or fund for another that "The increase in its value (referring to the fund) added to the capital not the income." The Court cited BOARDMEN v. MANSFIELD, 79 Conn. 634, 66 A. 169.
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> In JORDAN v. JORDANS TRUST ESTATE 111 Me. 124, 88 A. 390, the Supreme Court of Maine quoted In re GERRY, 103 N. Y. 445 with approval: "If the will had required the trustee to invest in real estate, the rents, income and profits of which were made payable to the life tenant with the remainder over, it can not be questioned but that any increase in the value of the land from natural causes would have been an accretion to capital and inured to the benefit of the remainderman."

> In WILLIAMS v. INHABITANTS OF BOSTON, 215 Mass. 1, 102 N.E. 355, it is said: "In case of a trust, * * * any gain made by a change of investment is an accretion belonging to the corpus of the trust fund and belongs to those who own the corpus of the fund. Such gains become part of the corpus as much as the original money contribution to the fund."
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> Similar expressions are to be found in:
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> VANATTA v. CARR, 229 Ill., 47, 82 N. E. 367;
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> In re STEPHENS 80 N. E. 358, 187 N. Y. 471, 12 L. R. A. N. S. 814;
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> In re GERTENLAUB'S ESTATE, 24 Pacific 348, 198 California, 204;
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> CHASE v. UNION NATIONAL BANK (Mass.) 176 N. E. 508;
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> TOWNSEND v. U. S. (N. Y.) 3 Redf. Sur. Rep. 230;
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> See also:
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> 13 A. L. R. 1009;
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> 56 A. L. R. l.c. 1317;
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> BOGERT TRUST p. 385 and cases cited therein;
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> PERRY ON TRUSTS, 7th Ed. Vol. II, pp. 885 et seq.

We have been unable to find a Missouri decision bearing directly on the question under consideration - - even when involving a trust fund created by a will, but in the case of Hayes et al. v. St. Louis Union Trust Company et al, 298 S. W. 91, Ellison C. said:

> "It may be readily admitted for the purpose of discussion that everything in the nature of a return collected by the trust estate should be credited to the income account thereof; but it must be a <u>return</u>, not simply <u>capital increment</u>, and it must be <u>collected</u>."

The Court further adopted the Massachusetts rule in regard to stock dividends as differentiated from cash or property dividends, thus holding that stock dividends issued by a corporation in which the trustees of a fund held stock, became a part of the corpus of the trust estate there under consideration, as differentiated from income. The rule of decision established in the Hayes case indicates as an afortiori principle that the Missouri Supreme Court will follow the great weight of authority in holding that the profits from the sale of the trust res, or a part thereof, must be regarded as an accretion to the res or principal.

Therefore, if the fund created under authority of Article XI, Section 8 of the Constitution of the State of Missouri is to be treated as a trust fund (which it is), and is subject to the same rules of law governing trust funds in general (which we believe it is), the profits derived from a sale of the bonds in question must be considered as a part of the corpus and not as income. In other words, it is our opinion that the term "income" as used in the above section of the Constitution refers to the proceeds and profits from the trust res and <u>not</u> to the <u>gains in the fund itself</u> from an appreciation of its value as derived from re-investment. To further impress the point we dare say that in the event the value of the bonds under consideration had depreciated no one would contend that the loss incurred by a sale thereof should be deducted from the <u>income</u> as derived from the interest coupons, yet if the profits are to be so considered in one instance they are to be so considered in all instances.

In writing the above opinion, we are aware that the distinction made by us between capital and income differs in many material respects from the opinion of certain able economists. This difference is due to a difference in point of view -- economists attempt to ascertain the actual facts governing what is or is not income; we on the other hand, endeavor to ascertain the intent of the framers of the Constitution as expressed therein.

Yours very truly,

POWELL B. McHANEY,
Assistant Attorney General

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Approved:

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Attorney General