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Institute Examination in Law

BY SPENCER GORDON

[The following answers to the questions set by the board of examiners of the American Institute of Accountants at the examinations of November, 1928, have been prepared at the request of THE JOURNAL OF ACCOUNTANCY. These answers have not been reviewed by the board of examiners and are in no way official. They represent merely the personal opinions of the author.—*Editor, THE JOURNAL OF ACCOUNTANCY.*]

EXAMINATION IN COMMERCIAL LAW

NOVEMBER 16, 1928, 9 A.M. TO 12:30 P.M.

Answer no more than ten questions as directed.

Give reasons for all answers.

(Each question counts 10 points.)

GROUP I

The candidate must answer all the following questions:

No. 1. Give the essential elements of a contract and define or explain each element.

Answer:

The essential elements of a contract are:

(a) The parties must be of legal capacity. By this is meant that neither party can be under age, insane or acting under any disability that the law regards as rendering the party incapable of making a contract.

(b) There must be an expression of mutual assent of the parties to a promise or set of promises.

(c) There must be an agreed valid consideration. In order to have a valid consideration there must be a detriment incurred by the promisee or a benefit received by the promisor at the request of the promisor. In the case of mutual promises where each is the consideration of the other the promises are valid consideration if the promises given are for the performance of some acts which if executed would be a sufficient consideration for an obligatory contract.

The word detriment as used above means giving away something which the promisee had a right to keep or doing something which he had a right not to do. The word benefit as used above means the receiving as the exchange for his promise of something which the promisor was not previously entitled to receive.

That the promisor desired it for his own advantage and had no previous right to it is enough to show that it was beneficial.

(d) The agreement must also not be declared void by statute or common law. An example of a contract declared void by common law would be one that is opposed to public policy, such as a contract in aid of a public enemy or a bootlegging contract.

No. 2.

Detroit, Michigan, October 2, 1928.

Thirty days after date I promise to pay to the order of John A. Miller, five hundred and 00/100 dollars at the Second National Bank & Trust Co.

GEORGE M. CHAPMAN.

Give the circumstances in which each of the following endorsements might have been made on the above note:

(a) GEORGE M. CHAPMAN.

(b) Pay to the order of Lester C. Mayer.

GEORGE M. CHAPMAN.

(c) Pay Lester C. Mayer only.

GEORGE M. CHAPMAN.

(d) Pay Industrial Savings Bank for deposit.

GEORGE M. CHAPMAN.

Answer:

There is a mistake in this question. Where "George M. Chapman" appears in (a), (b), (c) and (d) it should be "John A. Miller" and the question will be answered as if it were worded that way.

(a) Miller discounts the note to Mayer who, however, desires further to negotiate the note without the necessity of his, Mayer's, endorsement and identification. Miller, therefore, endorses the note in blank, thus making it "bearer paper."

(b) Miller desires to pay a debt owing by himself to Mayer, but the latter does not desire the risk of holding bearer paper. Miller, therefore, endorses "specially," thus requiring Mayer's endorsement before it becomes again negotiable.

(c) Miller has authorized Mayer to collect the note for him. He, therefore, puts on a restrictive endorsement which constitutes Mayer his agent and practically prohibits further negotiation except for collection purposes.

(d) This is also a restrictive endorsement and results in making the bank the agent for collection, the proceeds to be credited to Miller's account.

No. 3. A client of yours leases a plot of land for a term of 21 years with a right to renew the lease for a further term of 21 years. Your client erects a building on his leased land. The building has an estimated useful life of 35 years. The lease provides that upon the termination thereof the building shall become the property of the lessor. Under the federal income-tax law what yearly deduction, if any, could you take to cover the cost of the building to your client?

Answer:

He should deduct 1/35 of the cost each year if the building is used for business purposes. If the building is used as a residence he should not deduct anything.

No. 4. Distinguish between a partnership, a joint stock association and a corporation.

Answer:

A corporation is an artificial entity brought into existence by the sovereign power of the state, and the individual liability of its members is completely eliminated unless some part of that liability is especially reserved by statutory or constitutional provision. Its members or shareholders can transfer their shares or interest to another without the consent of other shareholders. As such artificial entity it can take and hold title to property. It can sue and be sued in its name. It can sue its shareholders and be sued by its shareholders.

A joint stock association is formed by written agreement of individuals with each other, and its whole force and effect in undertaking and creating the organization rests upon the common-law-right and power of the individuals to contract with each other. The relation they assume is entirely the product

of their mutual agreement and does not depend upon any grant from the state. The individual liability of the members, therefore, remains intact unless there is express statutory authority for its elimination. A joint stock association does not hold title to real estate in its name but usually title is vested in trustees for the benefit of the association. The capital and ownership of a joint stock association are represented by shares of stock which are as in the case of corporations transferable at will. As in the case of the corporation the death of a shareholder does not dissolve the association. Under the common-law rule a member of a joint stock association can not sue at law another member on a contract with the association nor could a member under the common law have sued the association. In some jurisdictions there are statutes which limit the formation of joint associations and these statutes have made them very similar to corporations. For example, they have permitted a member to sue the association in the same manner that a stockholder can sue a corporation and they have permitted the association to be sued in its own name whereas at common law this could not have been done. As in the case of a corporation a joint stock association can exist forever.

A partnership is fundamentally based on the right of individuals to contract with one another and it does not derive its authority from the sovereign. It does not exist as an entity separate from its members and it can not sue or be sued in the partnership's name. The members are usually known to each other and are bound together by ties of mutual confidence. The members of a joint stock association are not usually known to each other. The interest of a member of a partnership is not transferable at will as in the case of the interest of the member of a joint stock association or corporation and the death of a member of the partnership terminates the partnership. A partner as such may contract for the partnership and bind the other members individually.

Generally those who deal with a stock association are supposed to know that authority to manage its business is conferred upon its managers or directors and that a shareholder as such has no power to contract for the association.

No. 5. Best made a promissory note jointly with Kelly for Kelly's accommodation. Kelly altered the note into the note of a corporation, in which both were officers, forging other signatures and causing Best's signature to appear as that of a personal endorser of the note. The X bank, a holder, in due course, sued Best personally upon this endorsement. Could it recover?

Answer:

X bank could not hold Best liable as an endorser on the note of the corporation, for the corporation's signature was forged and Best's signature as an endorser was also forged. The negotiable-instruments law provides that where a signature is forged or made without authority no right to enforce payment thereof against any party thereto can be acquired through or under such signature. This section, however, goes no further than to make such signature inoperative and to bar the enforcement of a right founded thereon. It does not purport to declare the instrument void nor the genuine signatures thereon inoperative. Another section provides that where a negotiable instrument has been materially altered without the assent of all parties thereon except as against a person who has assented thereto it is avoided, and provides further that when an instrument has been materially altered and is in the

hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor. Possibly, therefore, the X Bank could hold Best to his liability according to the original tenor of the note which would be as an accommodation maker.

GROUP II

The candidate must answer five of the following questions:

No. 6. Jones lent Smith \$50. At the time Jones stated that he owed Fisher \$50 which he had promised to pay the next day. Smith in consideration of the loan promised Jones that he would pay the \$50 to Fisher the next day, which, however, he failed to do. Fisher sued Smith on Smith's promise to Jones. Could he recover?

Answer:

This is a contract for the benefit of a third party of the type known as the debtor-creditor type. In some jurisdictions the third party can recover and in some jurisdictions he can not.

No. 7. A owes B \$10,000. B takes out a policy of \$10,000 insuring the life of A. Subsequently A pays the loan in full but B continues the policy. Is it valid?

Answer:

No. While A was a debtor of B the latter had an insurable interest in A's life. When the debtor-creditor relationship ceased there was no longer an insurable interest.

No. 8. What is a bill of sale?

Answer:

A bill of sale is a writing in the form of a receipt acknowledging payment of the consideration for the property therein described and showing a present transfer of title from the seller to the buyer.

No. 9. In what circumstances is it necessary for a holder to present a bill of exchange for acceptance?

Answer:

The negotiable-instruments law provides that presentment for acceptance is necessary only (1) where presentment is essential to fix the maturity of the instrument; (2) where the bill expressly stipulates that it shall be presented for acceptance, or (3) where the bill is drawn payable elsewhere than at the residence or place of business of the drawee.

No. 10. Are dividends on stock of corporations taxable under the federal income-tax law when received (a) by an individual, (b) by a corporation?

Answer:

(a) Dividends are taxable to individuals. They are subject to the surtax but not the normal tax.

(b) Dividends are not taxable to a corporation.

No. 11. X, stockbroker, is insolvent but refuses to make an assignment for the benefit of his creditors, or to take any other action. Is there any way by which his creditors can bring about a distribution of X's assets pro rata between them?

Answer:

Yes. By filing an involuntary petition in bankruptcy against X. There must, however, be an act of bankruptcy in order to do this. Permitting,

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while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or final disposition of any property affected by such preference vacated or discharged such preference, would be an act of bankruptcy.

No. 12. You enter into an agreement with the Y corporation to purchase 100 shares of its preferred stock at its par value of \$100. The Y corporation agrees upon receiving payment to issue to you the 100 shares of preferred stock and 10 shares of its fully paid non-assessable common stock of the par value of \$10. Upon payment you receive the stock, the common stock having printed across its face the words "Fully paid and non-assessable". Subsequently the Y corporation becomes insolvent and its trustee in bankruptcy sues you to recover \$100, the par value of the common stock. Can he recover?

Answer:

Yes, the trustee can recover. It is a fraud on creditors for a corporation to issue stock as fully paid for less than its par value. This is the rule unless the corporation is expressly authorized by its charter or by a general statute to issue stock in the manner described in this question.

No. 13. A held the note of B for \$300 due August 15, 1928. On July 5, 1928, A accepted from B \$275 in full payment of B's note. Subsequently in August A sought to collect a balance of \$25 from B. Would he succeed?

Answer:

No. A was not bound to pay anything prior to August 15, 1928. Payment by him of \$275 on July 5, 1928, in full payment of the note, therefore, discharged his obligation.