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Legal Notes

HAROLD DUDLEY GREELEY, *Editor*

NEGLIGENCE OF AMATEUR AUDITORS

By statute in New York, the board of directors of every bank must make an audit of the bank each spring and fall. It may do this by a committee of at least three of its members, and the directors have the power to employ such assistance in making the examination as they may deem necessary (N. Y. banking law, section 130). The prescribed examination is a thorough one, covering fully the books, papers and affairs of the bank "and particularly the loans or discounts made directly or indirectly to its officers or directors." It is common practice for the directors of the larger banks to employ professional auditors to assist them, but the statutory provision about assistance is permissive and not mandatory and home-made audits are by no means rare.

In a city in central New York, an examining committee of three directors of a bank made an audit of its affairs. Their report "did not reflect the true condition of the bank, which had been systematically looted over the years by its president with the connivance and assistance of practically the entire working force, including the bookkeeper. The report did, however, reflect the condition of the bank accurately as revealed in the books of the bank, which balanced every night," writes Judge Hinman in *People* v. *Horvatt*, 261 N. Y. S. 303, 309. The balance-sheet was in agreement with the books, but unfortunately the books happened to be wrong.

The three auditing directors were tried and convicted of making a false entry in their report with intent to deceive the state superintendent of banks. Their conviction was reversed by the appellate court on the grounds that there was no motive or intent on their part to deceive or to fail to inform themselves, that there was no proof that they knew of the falsity of their report, and that the evidence did not show them to be guilty of such failure to inform themselves as to permit the inference that they were willfully ignorant and thus intended to deceive. "Even in a civil case," wrote the court, "it had been repeatedly held that when evidence relied upon to establish a fraudulent intent does not necessarily lead to that conclusion but is equally as consistent with innocence as with wrong-doing, that construction must be given to it which will exonerate the party. . . . If this is true in civil cases where a fact may be established by a mere preponderance of evidence, certainly there is a greater necessity for its application in a criminal case which requires guilt to be established beyond a reasonable doubt."

This case is interesting in its human aspects. As stated in the reported decision cited above, there was absolutely nothing to arouse the suspicion of any auditor. A firm of public accountants had made audits during preceding years and the state bank examiners had regularly made audits. Neither had discovered that the bank had been looted. The president, the principal offender, was a man of the highest standing in the community. "He was a man of good habits, never smoked or drank, was attentive to his church duties, had been decorated by the Pope for his services to his people, and was treasurer of

the Greek catholic union, involving the control of large sums of money. . . . The conniving employees had been with the bank from the beginning and were men who bore an excellent reputation." The government during the trial strongly urged that this president was a bootlegger. One witness testified that at one time liquid leaked down from an upper floor over the bank and that there was a strong smell of alcohol in the bank. But the appellate court found no actual evidence of bootlegging and nothing to prove that any fact apt to arouse suspicion was brought home in any way to the auditing directors. Here certainly was a situation which tested the auditors' maxim that nothing is to be taken for granted.

INCOME FROM LIFE INSURANCE

The necessity for distinguishing income from principal was illustrated recently in an unusual situation. A debtor was receiving payments periodically from a fund accumulated under a life-insurance policy. Each payment included a portion of the principal and the interest on the constantly diminishing principal. The entire fund accumulated by the insurance company was being paid in equal monthly instalments. As the principal was being reduced, the amount of interest contained in each successive instalment of equal amount was reduced, and thus each successive instalment contained a larger proportionate part of principal. A judgment creditor of the debtor's procured a garnishee execution whereby the creditor was entitled to 10% of the income due to the debtor. The court decided that the creditor was not entitled to 10% of each instalment accruing to the debtor but that he was entitled only to 10% of the portion of each instalment that represented income. Those portions were constantly decreasing and the amount to be turned over to the creditor was found to be considerably less than any of the parties to the transaction had expected. When an accountant is given an opportunity to confer with the attorney for a creditor prior to an application for such a garnishee execution, he should advise against the use of the word "income" and recommend that the execution require the payment of 10% of the total amount of each instalment. *Crossman Co.* v. *Rauch,* 88 *N. Y. Law Journal* 1529.

IMPORTANCE OF TRANSFER TAX STAMPS IN STOCK SALES

The importance of complying with the provisions of state-taxation statutes was strikingly illustrated in a recent decision. Section 270 of the tax law of New York imposes a tax on all sales of capital stock and requires the person making the sale to affix and cancel certain transfer-tax stamps. A vendor of stock sued the vendee for a balance of the sale price, and the vendee defended on the ground that the vendor had not affixed the stamps or otherwise paid the tax. The court on appeal held that the failure of the vendor to do this was an absolute bar to his action against the vendee for the sale price. There was a dissenting opinion and the case may be appealed to the court of appeals, which is the highest ranking court in New York. *Cooper* v. *Gossett,* 89 *N. Y. Law Journal* 1182.

The majority opinion of the appellate division of the supreme court pointed out that this was an executed sale and therefore taxable. The evidence showed that the vendor offered to the vendee the correct amount of cash required for the purchase of the stamps and that the vendee replied, "Never mind, I will

put the stamps on myself. I am the secretary of this company." The vendee did not affix and cancel the stamps. Equitable considerations ordinarily would estop the vendee from taking advantage of his failure to keep his promise to affix the stamps whereby he misled the vendor to his own profit. But the majority opinion held that although the conduct of the vendee was unconscionable, the words of the taxing statute could not be disregarded. "Public policy requires that this tax statute be enforced, and overrides plaintiff's equities." The statute specifically states that no taxable transfer on which the tax is not paid at the time of the transfer shall be made the basis of any action or legal proceeding. The court decided that even though there were no intent to violate the law, when the vendor through ignorance of the law or through mere inadvertence fails to pay the tax, such failure precludes his right to a recovery in court because proof of the transfer could not be received in court.

A strong dissenting opinion was written by one of the judges. It stressed the facts that the vendee was the secretary of the corporation whose capital stock was sold, that he was and had been a practising attorney for twenty-nine years, and that he had known the vendor for many years. The sale of the stock was made at the vendee's law office and a material part of the sale price had been paid before the vendor instituted this action for the balance of it. The dissenting judge wrote, "I do not think the court should lend a willing ear to the perpetration of such a fraud as the defendant (vendee) attempts." He then argued that the basis of the present action was a promissory note given by the vendee for the balance of the selling price and that the vendor did not need to offer any evidence relative to the transfer of the stock. This judge regarded the vendee as the agent of the vendor for the purpose of affixing and cancelling the necessary stamps and considered him estopped from relying upon his failure to do so.

It is a matter of human interest, as distinguished from the application of scientific principles of law, to note that the balance for which action was brought was $465.68 and that the amount of tax involved was ten cents.

JOINT VENTURES

A few months ago the supreme court of Alabama had to decide a novel point on joint ventures. A bridegroom and his bride were on a honeymoon trip in an automobile. While the husband was driving the car, an accident occurred and the wife was injured. An action for damages was brought and on the trial there was evidence showing that the bridegroom was negligent in his driving. As a matter of law, the negligence of a husband in driving an automobile is not imputable to his wife when she is a passenger with him, and therefore his negligence alone would not prevent her from recovering damages in a proper case. In this instance, however, the defendant argued that the ordinary rule of law did not apply because a honeymoon was a joint venture or enterprise, in the conduct of which the newly-wed husband and wife exercised equal authority and control. The Alabama court, after due consideration, gravely decided that a honeymoon was not a joint venture. *Newell Contracting Co.* v. *Berry*, 223 Ala. 109.