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Book Reviews

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Book Reviews

PROFITS, DIVIDENDS AND THE LAW, by PROSPER REITER, JR. *The Ronald Press Company*, New York. 260 pages.

In a discussion of accountancy a few years ago, a well known lawyer remarked, "It doesn't make any difference what you accountants call this or that, the only thing that counts is what the law says upon it."

It is fortunate for the progress of accountancy that this lawyer's statement is not true. Probably the one phase of business which compels the most interest is the question of profits. If the accountant were limited by what the courts have said with regard to this most vital matter, the subject would be in a jumble indeed. Net profits or net income is of such importance as the goal of business operations, that it is unfortunate that no agreement has yet been reached between economists, business men and the law with regard to the exact measuring of this element.

True net profit, however, is a result of certain economic laws and principles which can not be altered by judicial enactment or court decision. The best the law and the courts can do is to endeavor to fall in line with these fixed laws. The more one studies this subject, the more one is impressed with the distance yet to be covered before the average decision of the lower courts can catch up with the progress that has been made in the determining of these laws and principles by business men and by accountants.

Recourse to court decisions must frequently be had, however, in the matter of net income, particularly in the measuring of income legally available for dividends. This subject is so important that it is surprising that there are not available more treatises collecting and codifying the various decisions upon this point. In *Profits, Dividends and the Law*, Prosper Reiter, Jr., J.D., has attempted to meet this need. His work is worthy of great commendation. The amount of research that must have preceded the production of this work is staggering. So far as this reviewer is aware, the book is a pioneer in what it attempts to do and, as such, all the more praise should be given to the author for his successful accomplishment of what was unquestionably a most difficult task.

The book is divided into two parts: the first is concerned with British law which the author carries from very early decisions down to modern times, and the second is concerned with American law and practice. The second part might well be considered as in itself divided into two sections; the first including chapters nine to sixteen, and the second, chapters seventeen to twenty-one. This latter half of part II might be considered as a summary of the whole work, for in it, particularly in the chapters devoted to surplus and reserves, are accumulated the accounting doctrines which underly all the elements discussed in the other chapters.

The author seems to have investigated a surprising number of legal decisions and has drawn from each of them the gist of the decision so far as it relates to the particular items under discussion. He has not been content to accept the usual digest of these decisions, as such a digest frequently presents an incorrect

conclusion and oftentimes results in giving the decision credit for establishing a fundamental principle, when in reality it was only made with regard to the specific facts presented in the case and without any attempt to establish any fundamental doctrine. The author has made these distinctions with great care. Also he has not hesitated in many cases to point out the fact that the rulings as made frequently can not be taken as proper precedents, first because in many cases commercial practice and procedure have changed to such an extent since the decision was made that it could not be considered as an expression of what the same judge might rule were he alive and sitting today in a similar case; and second because the decisions were frequently made because of the combination of elements in the specific case under review and should not rightfully be considered as the proper judgment in other cases where certain outstanding elements were the same, but secondary yet nevertheless important considerations might be different.

It is well for those who make use of the book that it was written by a man who not only knows law but also knows fundamental accounting principles. For it is in the light of his comparison of the legal decisions with the principles recognized by accountancy as applicable, that the book has its greatest value. The character of the principles which form the basis for his accounting viewpoint are readily understood by his continuous reference throughout the book to the works of Henry Rand Hatfield, who appears to have been his mentor in this subject. Unfortunately this praise for Mr. Reiter can not be applied uniformly to all the opinions which he expresses in the volume. It is to be regretted that upon certain of the subjects discussed, such as depreciation, deferred assets and certain other contributory elements in the determining of net profit, the author has not delved a little further into some of the modern authorities on accountancy who have drawn distinctions and established principles which if applied in this volume would have clarified many things that are left ambiguous and would have made the volume more useful in these particulars.

This reviewer can not but regret that the author of the volume was not more specific in his statement in the early sections of the book of what constitutes good accounting with regard to the subjects under discussion. The reader who might go no further in the volume than the first one hundred pages would have a very confused viewpoint as to what was correct and what was not unless he had in advance a clear understanding of accountancy. This criticism does not apply to some of the later chapters such as the chapter on surplus which is very clear and in accordance with the accepted principles of modern business and accounting. The volume therefore possesses one element of danger to the non-trained reader who does not complete the work. This criticism, however, must not be construed as reflecting upon the value of the book as a whole.

It is interesting to follow the changes in the viewpoint of the courts from the earlier decisions such as in the famous case of *Lee v. Neuchatel* and other weird rulings of that day down to the present-day opinions, and to note the developments and the refinements of accounting definitions as evidenced therein. It presents a vivid history of the development of thought in keeping with the development of business. Accountants, corporation attorneys and investors in corporate securities should find the discussion particularly interesting and enlightening.

With regard to many of the court decisions, Mr. Reiter has pointed out what he considered an error of the court, but in many instances has qualified this criticism by a paragraph in which he excuses the court by stating that no doubt there were other points in the case in hand which were not clear in the decision but which caused the court to make the decision it did. The reader frequently feels that such alibis to the court are not justified. Probably Mr. Reiter's diplomacy, however, is excusable as criticism of court decisions is not yet accepted in all quarters with relish, and the thinking student is not really deceived by any such softening of the just criticism given to many of the court rulings.

Let us hope that the internal-revenue officers never read this volume and discover what some courts have held with regard to what constitutes net income. The chaos that might result from attempting to apply such decisions to the interpretation of the internal-revenue acts could not be viewed with pleasurable anticipation by many business men. On the other hand, how nice it would be to have the bureau define net profits in accordance with other quoted decisions, such as: "The words 'net profits' mean what shall remain as the clear gains of any business venture, after deducting the capital invested in the business, the expenses incurred in its conduct and the losses sustained in its prosecution." Or try this one on your revenue agent. "It seems to me that in the absence of special agreement the profits of the year must necessarily be the receipts of that year, after the expenditure and whatever else in the way of depreciation fund and so on applicable to the particular case is set against it . . . if it is a mere question what were the profits made in a particular year, it seems to me that the duty is to ascertain what cash has been received and what cash has been expended, and, if that is fairly done, you know the profits of the year. If there is a large outstanding liability which can not be settled, the partners will estimate that, and it will not be considered as part of the profits."

In another case, the defendant included accrued interest receivable on United States bonds in its profit-and-loss account. In the course of its opinion, the court said, "It is not easy to comprehend how profits or surplus profits can consist of earnings never yet received."

A majority of accountants or of business men quite smug in their viewpoint as to what the law says with regard to this and that, may be somewhat shocked to learn some decisions such as one quoted with reference to the liability of stockholders for discount upon stock purchased, where the decision seems to be that the stockholders are not liable in case the additional stock is issued honestly by a going concern for its actual market value (as opposed to par value) "for the purpose of paying its debts, or for the purpose of procuring money for the prosecution of its business, where its original capital has become impaired by loss or misfortune. . . ."

This reviewer is under the impression that some of the most valuable judicial decisions with regard to the determination of what constitutes net income have been by the supreme court and some of the lower courts in cases resulting from the application of recent federal income-tax laws. Apparently these are not presented in the volume under review.

This treatise on profits, dividends and the law is unquestionably a valuable work, and while some things in it may be criticised it has gone a long way toward meeting a need which has been voiced by some of the leading authorities in business, economics, accountancy and the law. It may be called an

original book in its field and as such has set a high standard. It will undoubtedly be followed by other volumes going more fully into the subject, particularly with regard to the determination of the amount available for dividends in the case of no-par stock which has not been given much space in this volume. The paucity of the discussion in this respect is no doubt due to the fact that the no-par-capital-stock laws are so recent that there are very few legal decisions which may be mentioned as setting a standard for the proper interpretation of this subject.

The opinion of this reviewer and doubtless of many others who have realized the need of a study such as this, has been well expressed by Professor Hatfield in his introduction to the volume which closes with, "It is a pleasure, then, to greet a work so timely, so useful, and so well executed; a pleasure, in the present instance, perhaps mixed with a tinge of regret to one who had at one time himself hoped to write such a work. But to be supplanted by one better qualified lessens the regret, and it is always a pleasure for one interested in scholarly work to pass on the torch to a new generation, who with the nimble feet of youth are able to make far advances in the search for truth."

CHARLES B. COUCHMAN.