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Statement of the Ownership, Management, Circulation, Etc., Required by the Act of Congress of August 24, 1912.

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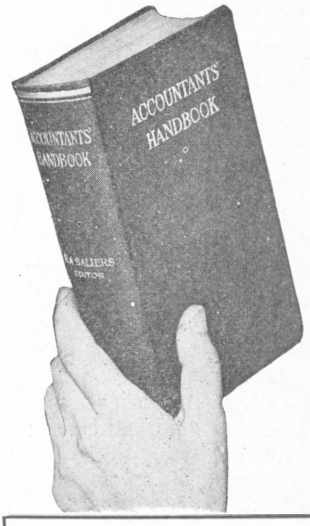

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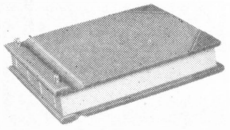

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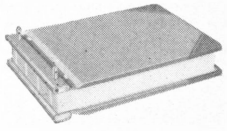

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Official Organ of the AMERICAN INSTITUTE OF ACCOUNTANTS

Vol. 36 NOVEMBER, 1923 No. 5

Need for Accountants as Receivers and Trustees*

By JOHN B. NIVEN

In 1910 the following statement appeared in THE JOURNAL OF ACCOUNTANCY:

> In England a large and lucrative practice in receiverships, trusteeships, etc., is conducted by chartered accountants, but in this country, we regret to say, comparatively little work of this kind has ever found its way to accountants' offices. There are, indeed, a number of cases in which accountants have acted as receivers or trustees, and we believe they have usually given satisfaction to those interested in the estates. Furthermore, these instances seem to be becoming more numerous. But as yet it must be admitted that the fees arising from this class of business form a very small percentage of the total revenues of the accounting profession.

The last statement, I am sorry to admit, still applies in almost if not quite equal degree.

My first impression, when I found that it had been delegated to me to open this conversation this morning, was that I had been asked to enunciate an axiom, and that I would find a practically unanimous consensus of opinion in favor, generally speaking, of the appointment of professional accountants as receivers; but I found, on investigation, that one authority, at least, had ventured to differ with this view. I hardly expect, however, that there can be room for much difference of opinion in this gathering.

The protest of this authority, however, offers a convenient opening for our discussion. In 1915, Willard P. Barrows made a most interesting and illuminating address upon the subject now under discussion to our friends of the Pennsylvania Institute of Certified Public Accountants, which was published in the JOURNAL, Vol. XXI. I commend this address to your consideration or

*Remarks at the opening of a discussion at the annual meeting of the American Institute of Accountants, September 18, 1923.

reconsideration. In an editorial which appeared in the same number of the JOURNAL, it was suggested that Mr. Barrows, after demonstrating conclusively the dependence which men appointed as receivers must place upon public accountants for assistance in certain departments of their labors, had overlooked a rather obvious solution of the problem as to who should be appointed as receivers by not proposing that accountants themselves are by education and training fit persons for such appointments.

Mr. Barrows thereupon wrote a letter, from which I will quote.

> It seems to me that I have sufficiently pointed out in my article the increasing tendency to specialization, and I have made a plea for the yet unrecognized and almost undiscovered professional receiver, for whom there is great need and opportunity. The ideal man for that place will not necessarily come from the school of accountancy, the law school, or any particular professional school. His most essential qualifications will be a broad, varied and successful business experience, particularly in business administration and management. He should be honest, broad-minded and fearless. His problems involve from time to time legal and accounting questions, and those of manufacturing, merchandising, transportation, engineering, mining, salesmanship, finance, employment, business negotiation and what not.
>
> * * * * * *
>
> It is an extremely narrow view to hold that the expert in any one of these lines is necessarily the one of all others best fitted for receivership administration. The services of the lawyer, the accountant and others are readily obtainable when wanted, but they are specialists, and the general administration of receiverships is not the specialty of any one of them.
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> * * * * * *
>
> If he (the editor of THE JOURNAL OF ACCOUNTANCY) insists upon the accountant being made receiver because "he is the man who is able to attend to all the duties of that office," I shall insist upon his preparing him especially for that profession.
>
> I mean no disparagement to any profession, but I do assert that business concerns in trouble should have more expert management than is ordinarily given them. Instead of grafting the job as a side line to another one, its special requirements should be the main consideration, and they are not necessarily to be found in any one profession or line of work out of several which could be named.

With much, if not indeed all, that Mr. Barrows says, I heartily agree. I admit even that the ideal receiver must possess the qualities of a sort of "Admirable Crichton" who is rarely found in real life. And it is conceded that no one man could be found who would ideally fit every condition which arises around us. I do submit, however, that the professional public accountant who has gone through the mill of an arduous technical education, supplemented by several years of the varied practical

experience which his daily work brings him, approximates, generally speaking, as nearly to the ideal kind of man for such duties as may be found. And let me add, in passing, that in most technical courses which aspirants to the degree of C. P. A. attend, attention is given to the study of receivership management, and in all examinations for admission to the profession—our profession — a knowledge of receivership management is expected.

In elaborating the argument, I do not propose to discuss at this time the general subject of receiverships, the circumstances in which receivers are appointed, nor the legal conditions applying to different classes of receiverships, although a knowledge of these, in general, at least, is essential to the practitioner who aspires to these appointments. However, it might not be amiss to direct attention to Mr. Barrows' article already referred to, to the excellent paper given to this body by H. C. Freeman in 1917 (particularly the opening paragraphs), and to the authorities quoted in both these papers. The legal work of the receivership will always, of course, be handled by a lawyer, and, whoever the receiver may be, he must always look to assistance from experts in various lines of endeavor for advice.

As shortly as possible, however, I shall endeavor to show that the ideal professional receiver and the professional public accountant fit together much in the manner that we learned long ago to argue out the result enunciated in the fourth proposition of Euclid.

What, then, is a receiver?

He has been described as "an officer appointed by a court of equity to assume the custody of property pending litigation concerning the same."

What are his duties?

Broadly speaking, the duties of a receiver are generally to protect and preserve the estate entrusted to his charge, and in due time, when his purpose has been fully performed, to return either the proceeds or the estate in its original form to those interested, who may be either creditors or the original proprietors, or both. Under the banking law a receiver's duties are set forth in great detail and here, at least, among other duties, he is specifically enjoined to keep accounts.

He acts, however, under the immediate supervision or direction of the court appointing him, and in matters of importance, necessity or doubt, is entitled to and indeed must apply to the court appointing him for instruction and guidance. Many of his tasks are, however, of an obvious character, and it is therefore his duty, with the aid probably of his counsel, to decide when he may act without specific authority and when an order of court is required.

As a practical proposition a receiver in many cases may find that he is little more than a liquidator, and that he can best serve those interested by the mere sale and collection of the estate entrusted to his care.

In the vast majority of cases, although not necessarily in all, the business to which the receiver is appointed will be found to be in difficulty, and, although in difficulty, this does not necessarily imply *in extremis*. It is in nursing sick business back to health that the large opportunities for receivers arise.

Either as an incident to the preservation of the estate for sale or in the nursing of it back to health, the receiver may find it advisable to carry on a business, even at a loss, with the hope of ultimately realizing a larger price or of eventually accomplishing a reorganization with all which that implies. This procedure may entail the necessity of temporary financing, authority for which upon a clear explanation of the situation the court will generally grant. But authority to borrow is not always synonymous with ability to borrow, and it may then become the duty of the receiver to find a lender—not always an easy task.

The receiver is liable for losses arising from his own carelessness, neglect or default, and except under special arrangements, he is also liable for any debts which he may incur if the estate becomes insufficient to protect them.

What, then, are the qualities required of a receiver?

From the foregoing outline of a receiver's duties, it is obvious that the aspirants for such positions must be men of many-sided talents and ability. I have already quoted Mr. Barrows' outline of his essential qualities. I will only add now that, except in rare instances, he must be an impartial or disinterested person—what is technically known in law as "an indifferent person"—and that he must have wide executive ability and a knowledge of business affairs generally, of finance, of accounting and of the

elements of commercial law. Sir George Touche in 1906 put it in the following words:

> Receiverships, with or without the incidental duties of manager, cover a wide range of affairs, requiring for their administration trained business capacity of a high order, a trustworthiness beyond question, and disinterested and impartial service. * * * The selection should fall on a man having a working knowledge of business principles and experience in the higher realms of finance, who, consistently with his professional and other pursuits, can spare sufficient time for the due performance of the important duties of his office.

Turning now to the other side of the question, let us consider

What is an accountant?

Or what rather is a professional public accountant? I cannot do better than quote Sir Arthur Dickinson who in his introduction to Robert H. Montgomery's first American edition of Dicksee's *Auditing* uttered what we in the profession have since looked upon as a classic which should be read and reread by every student of accountancy. I can only give some excerpts from this introduction—all of it, however, should be read:

> A public accountant is a person skilled in the affairs of commerce and finance, and particularly in the accounts relating thereto, who places his services at the disposal of the community for remuneration.
>
> This definition calls for three main qualifications:
>
> (1) Skill in the affairs of commerce and finance.
>
> (2) Special skill in the accounts relating thereto.
>
> (3) The application of this skill to the affairs of the community, and not merely of one corporation or firm, for remuneration.
>
> * * * * * *
>
> The moral qualities called for are so high that it should place the profession at the head of all which come into contact with business affairs.

This leads naturally to the next point in the discussion:

What is the character of an accountant's education?

This may be answered by the statement that it is, as indeed is all professional education, dual in character: (a) technical; (b) practical.

(a) The technical education comprises:

1. A liberal education on general subjects—which in certain states is of an extremely high standard.
2. Intensive study of accounting in its largest sense, including, in so far as they relate to business affairs, studies or reading in mathematics, economics, banking, commercial law and commerce.

(b) The practical education requires in every case practice in a public accountant's office, which incidentally brings the

student into touch with the practical working conditions of many and varied lines of industry, and frequently includes actual personal experience in some lines of business activity. There are few public accountants indeed who lack this latter experience.

Summing up, therefore, I only ask you to compare the two pictures, viz.: that of the ideal receiver and that which portrays the professional public accountant. Without assuming that our profession contains the only ideal receivers or that there are not numerous men outside the profession who are equally and probably in certain specific circumstances more qualified to act, I do repeat again that the educated public accountant, member of this body, perhaps, or holding certain of the state certificates, approximates as nearly to the ideal receiver as the member of any other of the professions, and that his training, indeed, almost entitles him to be enrolled in that other "unrecognized and almost undiscovered profession" to which Mr. Barrows referred.

That this has already been well recognized in England is evident, for we find it stated

> A chartered accountant [and I assume this would also, of course, include a certified public accountant] should be preëminently qualified to perform the multifarious duties that fall to a receiver, *and it is a recognition of this fact that the present practice* [i. e., the practice in England of frequently appointing accountants as receivers] has arisen.
>
> * * * * * *
>
> Skilled in accounts, familiar with commercial law and usage, acquainted with business of almost every description, and possessed of a knowledge of men and affairs, the members of the profession have now attained in England the rank and confidence which they have long enjoyed in Scotland, and which the C. P. A's. of the United States are securing with rapid strides.

Before sitting down I would only like to draw the attention of this body to one more paper which incidentally touches upon this subject, and is probably readily available to almost everyone here. I refer to Robert H. Montgomery's paper on *Governmental Supervision and its Effect on the Profession of Public Accountants,* which you will find in THE JOURNAL OF ACCOUNTANCY, Vol. X, No. 2. In his paper he refers incidentally rather critically to the character of some of the receivership appointments which he found were being made. I prefer, however, for the purpose of this discussion, merely to point out the excellent material which is available to the courts for this purpose in the now large and growing body of public accountants of the country.

Arbitration

By W. F. Weiss

At the annual meeting of the American Institute of Accountants, held in September, 1923, at Washington, the following resolution was adopted:

Resolved, That the Institute give to the work of the Arbitration Society of America its support; that it communicate with its members throughout the country, urging them to be favorable to the introduction of the system of arbitration in commercial disputes, and generally do everything possible to forward the popularity of arbitration, including service as arbitrators when called upon so to act.

The New York State Society of Certified Public Accountants at its annual meeting May 14, 1923, adopted a similar resolution, providing:

That the president be authorized to appoint a committee on arbitration, to consist of twenty members, to coöperate with the Arbitration Society of America, but without power to commit the society in any way.

Such a committee of twenty members of the New York State Society was subsequently appointed. The committee met in formal session and its report to the board of directors was transmitted by the board to the society at its regular monthly meeting on October 8, 1923, as the result of which the society voted to recommend to its committee on lectures and entertainments that it devote part of its regular monthly meeting on November 12, 1923, to addresses on the subject of arbitration with opportunity for full and free discussion.

A better understanding of the purposes, practices and benefits of arbitration on the part of the members of our profession, and in particular of the members of our Institute, of the New York State Society and other state societies, will no doubt prove of interest and lead to closer touch and contact with the subject of arbitration and its modern application to the lawful determination of business disputes and controversies, in preference to the economic waste of litigation. The substitution of arbitration for litigation is now sanctioned under the statute law of New York. In fact, this short-cut to substantial justice, which may appear to

savor of dangerous radicalism to the uninformed, has not only the sanction of the law, but the support of our courts and the cordial endorsement of many of our foremost judges, ablest lawyers and greatest merchants.

In accountants' growing intimate touch with the administration and pursuit of business, we must observe that the present enormous increase of litigation and consequent congestion of our court calendars have resulted in irksome and vexatious delays in the administration of justice, breeding disrespect of the law and dissatisfaction among the business community.

In 1920 the legislature of the state of New York enacted a law, which was signed by the governor on April 14th of that year, to bring relief from these cumbersome, irritating conditions through arbitration. That law gives to all disputants in New York the right to submit their differences for final determination to arbitrators, selected by themselves. That law also confers upon such arbitrators the full powers of judges; makes an arbitration agreement irrevocable, and gives to the award of an arbitrator the full power and sanctity of the judgment of a court of law.

The great trouble has been that few people know that this law is on the statute book. Only a small percentage of our merchants, and even of our lawyers, have any just and true conception of the really great power which this law places actually within the hands of our business men. Because of these conditions there has grown a skilfully organized movement which aims, through educational work, legislation and a practical operation of the arbitration law, to enlighten the business community and to spread the benefits of arbitration throughout all the other states of the union. This movement has taken corporate form. Its official title is the Arbitration Society of America, and although it is only a year and a half old and still in the beginning of its work in the cause of justice, it is well-known and cordially endorsed where unselfish effort for the common good is understood and honored.

The American Institute of Accountants is one of the many organizations representing great departments of activity in commercial and professional life of our country that have endorsed the movement sponsored by the Arbitration Society, and accountants can therefore now put the full weight of their influence squarely behind it. Not only should we aid the work with

practical support in New York, where we already have the arbitration law, but we should also aid in the vigorous campaign which the society is conducting for a like law in every other state.

What are the possibilities that await the accountant in this new field of arbitration? Will it broaden the scope of his professional services and usefulness?

This will be a practical and very natural query in the minds of many accountants, and as such it merits fair consideration and frank discussion. While I fully realize that the question of profit in dollars and cents will not weigh in the balance against a service for the public good with the members of our profession, yet the accountant, notwithstanding his professional attainments, is essentially a man of business and has a moral and ethical right to consider such a question.

To my mind, the popularizing of this direct and simple method of determining business controversies will doubtless increase the present and open new avenues of service to the accountant. This appears to be the conviction of the closest students of the business situation, who are following every step in the rapid progress of arbitration, analyzing its trend and classifying its requirements as they reveal themselves. The impression is prevalent among skilled observers that the accountant is destined to take rank as one eminently well qualified among trained and competent men of the professions and of business to act efficiently in the semi-judicial rôle of arbitrator, either alone or in association with others, as the disputants may elect.

Acting as arbitrator, however, is only one of the opportunities open to members of our profession. In the development and spread of arbitration practice, the accountant's value as a competent, efficient witness, consultant or advisor to the disputants will materially increase. Similar opportunity in this respect existed hertofore in serving litigants, but it was often limited, whereas in arbitration practice it will naturally expand. The limitation often arose from those rigid and complicated rules of evidence and the regrettably frequent use of objections, on the alleged but purely technical ground that testimony was irrelevant, immaterial or incompetent, whereunder so often truth has been silenced, insurmountable barriers have been raised to the admission of all of the facts, and justice skilfully and effectively sandbagged.

There are no technicalities in arbitration. Arbitrators, while they will exclude unrelated matters, which are time-consuming and may becloud the issue, are not bound by the rules of evidence, and all evidence bearing upon the case may be freely admitted. It is a simple, democratic procedure in which every disputant and every witness gives his evidence in his own way, before arbitrators selected by the disputants themselves for their integrity, intelligence, trustworthiness and special fitness to decide the particular issue.

By virtue of these provisions arbitration is bound to grow and, it does not seem visionary to say, will eventually largely divert from our courts those thousands upon thousands of cases, which embody on real analysis merely simple issues of fact yet sadly clog the court procedure and calendars and retard the administration of justice. I refer to cases involving only an issue of fact, where it seems a waste of time for a judge to hear the evidence, when he could be better engaged in consideration of questions of law, while at the same time there are men available better qualified to pass upon the particular question of fact than the average jury.

All things considered, it is not an unreasonable prophecy to predict for the accountant, skilled in the affairs of business, and experienced and accurate in the disclosure and demonstration of facts, a continually expanding field for his professional services and usefulness as witness, consultant and advisor.

As to the question of emoluments, and not referring to the services which may be rendered to either of the disputants on customary retainer arrangements, it may be expected that the arbitrators, unless they have registered their willingness to serve without compensation, will be remunerated in proportion to the importance of the issues upon which they sit in judgment, with some regard also for the economy in expense and expeditious procedure afforded to the disputants. But apart from the question of the financial emoluments for the arbitrator, the honor, dignity and benefit of such service to the business public will naturally constitute distinct and separate recompense and credit of great value.

The work of the Arbitration Society of America in providing arbitrators has revealed the significant fact that the invitation to this service is regarded as a distinction and high tribute to the

arbitrator's standing in the community and to his reputation for integrity and intelligence and to his sense of public duty, and the society has not had a single record of a refusal to serve.

A few more details as to the Arbitration Society of America, its aims, purposes and achievements, should serve to bespeak for it our profession's increasing staunch and substantial support.

The society owes its inception to the vision and effort of one man—Judge Moses H. Grossman—prominent among the lawyers of New York. It was his unselfish work—himself the head of one of the large and prominent litigating law firms in the country —that brought the society into being under a board of governors, the personnel of which commands the widest confidence and respect. This public-spirited group of men, who have unselfishly set out to put simple justice within the easy reach of their fellow-citizens in the settlement of business controversies upon issues of fact, includes such men as Frank H. Sommer, dean of the law school of Columbia university; Samuel McRoberts, president of the Metropolitan Trust Co.; Thomas J. Parkinson, vice-president of the Equitable Assurance Co.; Franklin Simon, merchant; Jules S. Bache, banker; Justice Charles L. Guy, justice of the New York supreme court; Almet F. Jenks, former presiding justice of the appellate division of the New York supreme court; William B. Joyce, president of the National Surety Co.; Henry Ives Cobb, architect; Robert G. Cooke, president of the Fifth Avenue Association; William C. Redfield, former secretary of commerce in the cabinet of President Wilson; David A. Schulte, of the tobacco trade; Samuel McCune Lindsay, of Columbia university and president of the Academy of Political Science; former United States Senator James A. O'Gorman; Robert Lee Hatch, former president of the New York Rotary Club; Marion McMillin, vice-president of the American Light & Traction Co., and Frederic Kernochan, chief justice of the court of special sessions, New York. Charles M. Schwab is chairman of the general committee.

The society, created as a membership corporation, so that no member can ever profit financially through its activities, started out under a charter which defines the purposes substantially as follow:

First: to conduct a national campaign of education in the cause of arbitration.

Second: to work for legislation designed to extend the benefits of arbitration throughout the country; and,

Third: to operate in New York, and other centers of population, public tribunals of arbitration conducted under a common-sense code of procedure, absolutely free from the technicalities and rules that make the machinery of litigation so cumbersome, so slow and so expensive.

This new tribunal of justice, established in New York by the society, has now been operating for one year and six months. Hundreds of controversies have been before it, and many of these have been determind in the preliminary stages of the arbitration. The issues determined have covered a wide range of business subjects and have involved individual amounts ranging from hundreds up to many thousands of dollars. But in every case the proceeding has been the simple bringing together of men in dispute who told their stories in their own way, and through the mouths of their witnesses, before arbitrators who disregard technicality and aim at justice.

Lawyers are welcomed by the society either as arbitrators or as counsel for disputants. In the first instance, the lawyer is the potential judge, trained in the weighing of evidence and, hence, a valuable arbitrator. Again, as the representative of the disputant, he can render effective service in the presentation of his client's cause before the arbitrator and in the questioning of witnesses, but he goes into the contest stripped of some of his legal weapons—those technicalities and rules that rigidly govern litigation.

I dwell upon this feature of the society's tribunal, because in the arbitration boards which are now operating in so many trades the lawyer is excluded. He is barred from participation in such proceedings. But under the broader policy of the Arbitration Society, the coöperation of the lawyer is regarded as of prime importance to the future of the movement, and lawyers following the lead of able judges are turning to arbitration, properly conducted, as the one great hope of relief from the intolerable conditions revealed in our crowded courts and in the law's delays which work for so many that greatest of evils, a denial of justice. The energetic championship of arbitration by foremost lawyers of New York aided quite materially in the passage of the arbitration law now in force.

Notwithstanding the individual policy employed by the society in the conduct of the public tribunal, the work it is doing is dedicated to the service of every trade organization that has arbitration machinery of its own, as well as to the service of the general public. Its tribunal is operated for the service of business men in dispute who either do not belong to trade organizations equipped for arbitration, or, if they do belong to such an organization, for some reason prefer to go before a public tribunal.

Moreover, there are some forms of controversy—questions arising out of accountings between partners, the determination of loss and compensation for damages in actions of tort, etc., which cannot be arbitrated in trade boards, but can be determined in the society's tribunal under the assurance and guarantee of responsibility which the distinguished character of its governing board provides beyond question.

The Rubber Association Board irons out disputes among rubber manufacturers and merchants. The Silk Association Board, and the Cotton Board, and many other boards concern themselves with the activities of their respective trades.

In that work, the society is rendering all possible aid by direct advice to disputants and by its broadcast educational work. Its own tribunal serves no particular trade. It is open to all trades and to the public—to all alike on equal terms—and at a trivial expense as compared with the expense of litigation. It is not operated for profit but is a public institution, designed to confer its benefits upon the public at large.

To detail the progress of the arbitration movement under the impetus which this powerful society has given it would far exceed the limits of this article, but certain outstanding facts in the record of the past year which strikingly show the development of the movement and reveal its promise of public benefits may be very briefly told.

Taking the field alone in May, 1921, to spread the gospel of arbitration, the society today has the official endorsement of sixty-two trade organizations, the Commercial Law League of America and many civic bodies. Only a few months ago, seventy influential trade organizations joined the society in celebrating throughout the state of New York an arbitration educational week (May 14 to May 20, 1923). It was the society's plan and it did earnest and effective work in carrying it out. That week stands out as

one of the most remarkable in the history of educational movements. There were sermons on the subject in the churches; talks on the theme in the schools; trailers on the news reels of the motion picture theatres; meetings of experts in arbitration procedure; breakfast, dinner and luncheon discussions in clubs and hotels and in the homes of the New York Chamber of Commerce and the Merchants' Association, and observances in the courts of New York in which leading jurists took an active part.

Such a demonstration in sympathy with a substitute for litigation attests beyond doubt that arbitration has taken a firm foothold and is here to stay and to grow. Our business men are waking up to the fact that the statute law of the state provides a way to justice in the settlement of many controversies—a short and inexpensive road—and that it also provides a way of escape from the fearful waste, in time and money and peace of mind, that flows inevitably from long-drawn-out litigation.

Another significant event of the year was a dinner last winter at the New York home of Mrs. Vincent Astor, who acted as hostess for the society. Sixty-four judges, representing all the courts of the state of New York and all local branches of the federal courts, attended this dinner. At its close, the diners met 250 representative men of the trades and industries who had been invited to join in an after-dinner discussion of arbitration. The outcome of this gathering was the passage of a resolution strongly endorsing the work of the society, and the appointment of a committee, made up of judges of our higher courts, to act in support of the movement.

The brief recital of these events will serve as evidence that there is no conflict between the law and arbitration—between the courts and the tribunal which the society is operating. On the contrary, the tribunal of arbitration will serve alike the courts and the cause of justice in lifting a mighty burden of unnecessary litigation, where issues of fact are involved, from the shoulders of our judges—and the judges bid it hearty welcome.

The recent enactment of the New Jersey arbitration law, which closely follows the New York statute, marks the first step towards the fulfillment of the society's national programme for a uniform arbitration law.

In concluding this brief outline, it should not be overlooked that one of the strongest auguries for the future of arbitration is

to be found in the support of the press. Arbitration has been editorially endorsed by leading newspapers of every state, just as it has been approved by leading men in every trade and industry. We, as accountants, can bring credit to our profession by active assistance and support of the movement. A practical step in this direction is coöperation with the Arbitration Society of America, with the advocacy of arbitration whenever and wherever opportunity affords.

Balance-sheet Uniformity

By Louis G. Peloubet

An article in a recent number of *The Accountant* contains the thought-provoking statement: "Figures are in themselves a language * * * the true purpose of figures is to convey to us a correct appreciation of the facts." Looking over published balance-sheets with this in mind it strikes one that if figures may be likened to words may not sequence and grouping be said to parallel phrases and paragraphs—that *arrangement* of the figures is fundamental to comprehension.

A study of the balance-sheets of seventeen prominent corporations finds the main groups of assets listed in eight and liabilities in six, different orders and makes one wonder why a profession based on alertness should tolerate so palpable a flaw in its public output. Perhaps it is because the subject involves so many points: sequence of main groups; contents of each group; sequence within each group; condensation; terminology; arrangement for a going concern, for realization, as a basis for credit.

It is truly a monumental undertaking to conform and agree upon all this and only time may accomplish it. But might not a start be made by agreeing upon one thing—sequence of the main groups, for example, as perhaps the least difficult and at the same time the most important, inasmuch as that sets up a frame-work on which to hang the rest?

As a suggestion, subject to any modification and with the understanding that it is here intended only to distinguish—not name—the main groups for a going concern and not to involve any other point, taking the items as they appear on those seventeen balance-sheets, uniform adherence to some such main group-order as the following would have an intelligibility value which readers of balance-sheets would appreciate:

On the asset or resources side:

Group 1—Comprising the lasting physical assets less any decrement. Those which are natural resources

(land; mines; oil lands; timber lands; deposits—less portion converted to other forms, such as stumpage; depletion actually sustained) and those which might be termed artificial (buildings; plant; machinery; equipment; apparatus; tools; fixtures; furniture; long time expenditure such as development, stripping, improvements on leased property—less proportions disappeared by lapse of time or in operations, such as depreciation actually sustained, expenditure written off).

Group 2—Comprehending those assets which are in the nature of vested rights (goodwill; patents; franchise; trade-mark; trade-name; copyright; lease; organization expense).

Group 3—Containing investments of a permanent nature. Those controlled (subsidiary, affiliated, constituent or auxiliary businesses, including permanent advances to such and less permanent liabilities thereto) and those not controlled but in related or connected industries (usually held for business purposes, including permanent advances to such).

Group 4—Such assets as are set aside in the form of funds for a specified purpose (insurance; pension; depreciation; special funds in trust; contingent).

Group 5—Covering those assets which, converted from cash, are absorbed in the ordinary course of business in future operations. Those which exist physically (material; supplies) and those which represent a service rendered or to be rendered (insurance, taxes and interest prepaid; advances on contracts; advanced royalty; bond expense).

Group 6—Embracing cash and such assets as are in the ordinary course converted into cash. Those which consist of claims against others (unpaid subscriptions to capital stock; interest accrued; dividends receivable; call, demand or time loans; accounts receivable) and those which are physical (inventories; notes receivable; government and marketable securities; cash).

On the liability or equities side:

Group 1—Those representing ownership—in the parent company (capital stock, less non-effective portion in treasury or acquired for permanent holding and less encroachments thereon, i.e., deficit) and in subsidiary companies (minority interest in stocks, bonds and surplus of consolidated subsidiaries).

Group 2—The residual or balancing figure (earned, free, paid-in, capital or appropriated surplus).

Group 3—Provision, more or less voluntary, made in the form of reserves and as a precautionary measure (fire insurance; employers' liability; renewals and replacements; pensions; employes' benefits; obsolescence; depreciation not actually sustained; contingencies).

Group 4—Covering liabilities arising in a sort of fiduciary capacity and usually offset by like amounts on the asset side (special funds held in trust).

Group 5—Borrowed capital—fixed (bonds; funded debt, less non-effective portion such as unamortized discount; sinking fund) and temporary (bonds assumed; purchase-money obligations; notes payable; loans).

Group 6—Embracing those more or less immediate obligations which continuously arise in the normal conduct of the business—those of which the amounts are estimated or approximated (employers' liability; workmen's compensation; renewals and replacements; taxes; unpaid charges) and those of which the amounts are fixed (notes payable; loans payable; unclaimed dividends; customers' deposits; services billed in advance; amounts temporarily due to subsidiary companies; accrued rent; interest and taxes; accounts payable; wages payable).

It can be done. Some associations have already progressed far, and a few have accomplished much, in this direction. Is it too much to expect of accountants? And, if so, why?

A Tax on Living Expenses

By J. A. Cull

An income tax to be ideal should have the following attributes:

1. It should be simple of computation and a matter of advance knowledge of the taxpayer.
2. It should penalize wastefulness and reward thrift.
3. It should not burden production more than is necessary.
4. It should encourage investment in industry.
5. It should conduce to lower prices.
6. It should yield a constant income to the government.

In short, it should do the things that the present United States income-tax law does not do, and should not do the things which the present law does. The present law is anything but simple in interpretation. Already we have volumes of court decisions, treasury decisions, solicitor's opinions, departmental rulings and regulations, opinions of the attorney-general, solicitor's memoranda, recommendations of the committee on appeals and review, etc. Nor is the method of calculation of tax even moderately intelligible. The computation of the tax liability in the case of individuals alone involves five distinct devices for placing the larger burden on the larger income. One should be sufficient.

The reported cost of administering the income-tax laws for the year ended June 30, 1922, was $41,500,000, and the cost to the taxpayers outside of taxes for conferences, expert advice, etc., has been estimated at $140,700,000 annually.

The taxpayer has no assurance when he has paid his income tax on March 15th that the matter is settled. For five years he is in danger of an assessment and such assessment may, and often does, arrive after four lean years when the profits of that year of large income have all been dissipated. The man who saves his substance and invests in productive enterprise is an economic asset to the nation. His savings make possible new industry which adds to the total wealth and affords employment for more labor.

The man who spends his earnings in riotous living adds nothing to the national wealth and he should be penalized rather than the other. The present law discourages investments by heavy

taxation. Certainly investment in productive enterprise is not fostered and investment in state securities tends to wasteful public expenditure. Production should be released entirely from tax burden. We should recognize that the consumer pays the taxes and in this recognition stop fooling ourselves with any other idea. Our failure to recognize that fact and our vain efforts to place the burden there does not tax production but it does hamper and even in a large measure stifles production. Tax-exempt securities are draining industry of capital. A taxpayer whose income is in the higher brackets pays fifty per cent. to the government if it is derived from industry, but if its origin is state-bond interest, he pays nothing at all. Clearly, industry will not be favored with investment when there is such an alternative.

Prices necessarily reflect a certain inflation under present conditions. The law of supply and demand, at least in its minor reactions, is materially affected by artificial manipulation. Even if this were not so, the effort to shift the burden of taxation to the consumer would be largely successful. There is a certain volume of wealth in the country and only so much. A certain amount of that wealth must be converted to the uses of government. If taxes were equitably apportioned, there would be no room for taxing another product, another industry, or another accumulation of capital to compensate for lack of government income from established sources. Yet when more income is needed, this is the method employed.

A tax which not only avoids the inequities of the present income tax but operates constructively to promote industry and create wealth is proposed in a tax on basis of the living expenses of the individual. Corporations and like organizations should be taxed not at all. The earnings of the corporation must sooner or later find their way to the pockets of individuals and while en route they are promoting the production of wealth, creating employment and consequently paying living expenses of other individuals. Corporations are merely the agencies of individuals and the subjects of taxation are in no wise diminished by excluding them from the tax lists.

The individual should be required as now to account for his full income and his taxable income should be his net income less a fixed exemption, according to his marital status, which should approximate the dividing line between a wholesome standard of

living and extravagance and less investments in legal productive enterprise and government bonds. Thus, if a man's net income is $10,000, and the fixed exemption $2,400, and he uses $1,600 to purchase railroad bonds, $1,200 for interest and $100 for donations to charity, his taxable income will be computed as follows:

Income		$10,000.00
Less:		
Fixed exemption ..	$ 2,400.00	
Investments	1,600.00	
Interest	1,200.00	
Donations	100.00	5,300.00
		$ 4,700.00

The $4,700, therefore, representing his living expenses is the basis of his tax.

If he owns his own home, depreciation and up-keep are part of his living expense. If he rents, his rent is likewise part of his living expense. As neither item is a deduction from income they need not be considered. Nor, obviously, should the original purchase of a home be considered a deduction, but the corresponding tax thereon should be spread over a term of years like depreciation.

The tax rate should be graduated sharply but by the use of one formula and one only. To be sure, this formula would be borrowed from higher mathematics and not intelligible in nature and computation to the layman, but certainly the computation of taxable income which is the basis of the tax and the whole story to the taxpayer would be simple indeed of calculation. The result would seem certainly to promote thrift and discourage prodigality, as the rewards would go to the one who saves and the penalty to the spender. It would burden production least of all taxes since the tax is placed on the ultimate consumption, as far removed as possible from the production. It would encourage investment. Who would hide his talents and thus be liable for a tax on them rather than place them where they would yield an income and at the same time be non-taxable?

Tax-exempt securities, the crying wrong of the present system, would lose their attractiveness in comparison with industrial investment if industrial investments were likewise tax-exempt,

and strikes and lockouts which at present attend capital-drained industrialism would expend their energy in new enterprise.

For the same reason that it would but slightly affect production, the tax would likewise slightly affect prices to the ultimate consumer. Its yield to the government would be constant but only as it was made so. A tax commission should be empowered to fix from year to year the exemption and the tax rate commensurate with the needs of government. It would be far more logical, scientific, equitable and simple than to pass new laws to tax new industries or new taxpayers with all the attendant train of new rulings and decisions, to say nothing of the industrial readjustment and turmoil occasioned by such legislation.

It is not to be supposed that the fixed exemption under present abnormal conditions could be placed as high as is desirable nor that the rate of tax could be placed as low as would have been possible under ante-bellum conditions, but it would seem that this tax would operate in the direction of the production of a larger and larger volume of wealth, a larger and larger industrialism and, in the long run, a better and better standard of living as the fixed exemption increased with enlarged sources of government income. This is, therefore, not merely a system of taxation but a theory of economic government administration.

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A. P. RICHARDSON, *Editor*

EDITORIAL

Ethics in Tax Practice

The treasury department has shown a steadily increasing desire to regulate the practice of attorneys and agents before the bureau of internal revenue so that the administration of the tax laws of the country may be conducted with the least possible loss and inconvenience to both government and taxpayer. At first it was impossible to lay down rules which would be sufficiently comprehensive to prevent all undesirable practice, and many taxpayers were represented in a way which did no good to their cause and led to a great deal of dissatisfaction among officers of the treasury department. However honest may have been the intentions of some attorneys and agents, many of them lacked a keen perception of the difference between ethical and unethical acts. As a consequence there has been an accumulation of rulings designed to prohibit conduct which might be considered as unfair, if not actually criminal. It is always a difficult matter to lay down rules of conduct for a group of men whose purpose it is to obtain the best possible results for their clients. This fact is recognized by such organizations as the American Institute of Accountants, the American Bar Association, the various medical societies and similar bodies of professional men. Codes of ethics have improved little by little until today they are fairly comprehensive, but even at the best there must always be some omissions which will be brought to attention as offenses occur. The treasury, however, has shown a praiseworthy desire to cope with the difficulty as promptly as possible and the rules which have been promulgated have been productive of results. Their inhibitions have been irksome to many persons desiring to practise wrongfully, but that is as it should be.

From the Abstract to the Concrete

Now, however, the treasury has gone a step further and has practically adopted as its own certain rules and standards approved by the leading professional organizations of lawyers and accountants. In department circular No. 230[1], issued over the signature of the secretary of the treasury, the department takes a more definite stand than ever before. Every accountant, lawyer or other representative of taxpayers must comply with the rules of conduct which have been laid down by the American Bar Association and by the American Institute of Accountants. The following quotations from the circular indicate its comprehensiveness. The full text of the circular appears in the *Income-tax Department* of this issue of THE JOURNAL OF ACCOUNTANCY.

> In order better to protect the taxpayer's interests and to expedite practice before the department, applicants should clearly establish their right to enrolment by showing that they possess (1) a good character and reputation; (2) a sound education; and (3) a familiarity with the laws and regulations covering taxes or other subjects which they will present to the department. Practice before the treasury department is not restricted to duly licensed attorneys at law and certified public accountants; but an agent who is not an attorney or accountant and attorneys and accountants licensed in states where, in the opinion of the committee on enrolment and disbarment, the licence requirements are not adequate, must show satisfactory educational qualifications and evidence of an ability to understand tax questions or such other matters as will be presented to the treasury by the applicants. An applicant's character and reputation can only be established by inquiry among those who have had the opportunity of knowing the applicant in the community in which he has lived. A bad reputation as to integrity or any previous conduct of applicant which is unethical, as viewed by the standards of the American Bar Association or the American Institute of Accountants, or such conduct as would be considered unfair in commercial transactions, will be regarded as sufficient to justify the rejection of the application. References as to the applicant's character should be given, and in addition the applicant should furnish the names of those with whom he has come in contact in his business and of whom inquiry may be made. The committee on enrolment and disbarment will endeavor to ascertain all facts deemed necessary by it to pass on any applicant without expense or undue inconvenience to the applicant, but the committee may require, where it is not satisfied with the information received, that the applicant appear in person before the committee or its duly authorized representative.
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> Causes for rejection, suspension, or disbarment. — In general, any conduct which would preclude an applicant from enrolment will be sufficient to justify his suspension or disbarment. Specifically, the following matters, among others, will be considered grounds for suspension or disbarment:
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> (a) Violation of the statutes or rules governing practice before the treasury department.

(b) Conduct contrary to the canons of ethics as adopted by the American Bar Association or the rules of professional conduct approved by the American Institute of Accountants, or their equivalent.

(c) False or misleading statements or promises made by the attorney or agent to a taxpayer or misrepresentation to the treasury department.

(d) Solicitation of business by the attorney or agent. This includes letters, circulars, and interviews not warranted by previous association; printed matter appearing on the letterheads or cards of the attorney or agent indicating previous connection with the treasury department or enrolment as attorney or agent; or representation of acquaintance with treasury officials or employes. It includes also the use by attorneys and agents of any titles which might imply official status or connection with the government, such as "federal tax expert" or "federal tax consultant." It is not considered a violation of this regulation for treasury employes, on severing their connection with the department, to send out announcement cards, briefly stating their former official status and announcing their new association, provided the cards are addressed only to personal or business acquaintances, and provided further that such cards are distributed only at the time of severance of the official connection with the government. These cards are regarded by the committee not as advertising but as the customary announcement cards issued for the express purpose of identifying the sender with his new association or business.

To Protect the Taxpayer

It is pleasant indeed to be able to record this recognition accorded by the treasury department to the codes of ethics adopted by the leading professional organizations concerned. Both the American Bar Association and the American Institute of Accountants have repeatedly demonstrated their willingness to assist the government in the administration of tax laws, and both bodies have given consideration, time and again, to the prevention of undesirable practice by members of the professions which they represent. The ethical codes approved by the professional organizations have been adopted only after long experience and profound consideration. It is not believed that they can work a serious hardship on any honest practitioner, but they may be regarded as likely to prevent much misrepresentation of claims before the department and much otherwise reprehensible practice. The public is heartily tired of the activities of so-called tax experts whose sole claim to attention is their anxiety to extort fees and commissions. It is probably safe to say that there is not a taxpayer of any consequence who has not been solicited by at least one person or organization offering to obtain refunds or abatements and alleging peculiar ability for such service. If, as we believe likely, the treasury will rigidly insist upon the enforce-

ment of its present rules, it will be possible to exclude from practice the great majority of the unqualified and unscrupulous practitioners in income-tax work. We congratulate the secretary of the treasury upon the increasing evidence of his steadfast desire to make the administration of tax laws as fair as it may be.

Accountants and Bankers

One of the most gratifying developments in the activities of accountants as a profession is the growth of understanding between accountants and bankers. There was a time when there seemed to be a complete divergence of opinion on many points between these two classes of men, but as time goes on the differences are passing away and it is not unlikely that there will be an even better spirit of coöperation in future. At the last annual meeting of the American Institute of Accountants an important and valuable report was presented by the chairman of a committee on coöperation with bankers. The *Monthly Bulletin* of the Robert Morris Associates, which, as most readers know, is an organization of credit men of banks throughout the country, in its September issue contained a brief article by J. W. Richmond which may be quoted in full, with the hearty endorsement of the accounting profession:

> Within the past few weeks one of the justices in the United States district court of New York confirmed a report dismissing a reclamation proceeding, brought by a prominent silk corporation against the trustee in bankruptcy of a silk jobber, to recover merchandise alleged to have been obtained on the strength of a false financial statement, as the basis for the credit granted. The circumstances under which credit was obtained were not unusual. The corporation had been transacting business with the jobbing house for several years prior to the latter becoming bankrupt, and had extended a fairly liberal line of credit on the customary basis. Between the placing of the order and the date of delivery of the goods several weeks later an independent investigation was made relative to the condition of the firm, and a comparatively up-to-date statement was furnished. The strangely unusual feature of the case was that at the hearing in question the fact was conceded that the financial statement was actually false as alleged, but defense was able to sustain its contention that credit is granted on a company's record, length of time in business, manner of payment, method of honoring contracts, and the general knowledge of relations with competitors, etc., and that sole reliance is not placed upon the condition reflected by a statement; this, in spite of the fact that the other creditors had received a similar statement, and doubtlessly were favorably biased in the expression of an opinion in consequence thereof.
>
> This decision should have a far-reaching effect in credit circles if reliance cannot be placed in a company's balance-sheet. The answer is obvious. We must work in closer harmony with auditing houses, and we must insist that the financial statements submitted to us be

prepared with certificates attached by recognized and reputable firms of certified public accountants in whose work we would have confidence and against which we would have recourse. We should all work together to this end, and if this course is pursued the black sheep will gradually be eliminated.

Specific Recommendations

We have referred to the report of the special committee on coöperation with bankers and feel that further information should be given in regard to this important matter. The committee had been requested to consider the question of certification of a balance-sheet giving effect to transactions consummated at a date later than the balance-sheet. The matter was discussed by the committee with representatives of the Robert Morris Associates, and certain rules were suggested which received the approval of the council of the Institute. The report will be printed in full and distributed to Institute members, but the rules are of interest to all accountants and are presented herewith.

I. The accountant may certify a statement of a company giving effect as at the date thereof to transactions entered into subsequently only under the following conditions, viz.:

(a) If the subsequent transactions are the subject of a definite (preferably written) contract or agreement between the company and bankers (or parties) who the accountant is satisfied are responsible and able to carry out their engagement;

(b) If the interval between the date of the statement and the date of the subsequent transactions is reasonably short—not to exceed, say, four months;

(c) If the accountant, after due inquiry, or, preferably after actual investigation, has no reason to suppose that other transactions or developments have in the interval materially affected adversely the position of the company; and

(d) If the character of the transaction to which effect is given is clearly disclosed, i. e., either at the heading of the statement or somewhere in the statement there shall be stated clearly the purpose for which the statement is issued.

II. The accountant should not *certify* a statement giving effect to transactions contemplated but not actually entered into at the date of the certificate, with the sole exception that he may give effect to the proposed application of the proceeds of new financing where the application is clearly disclosed on the face of the statement or in the certificate and the accountant is satisfied that the funds can and will be applied in the manner indicated. It is not necessary that the precise liability shown in the balance-sheet before adjustment should actually be paid out of the new money. It is sufficient, for instance, where the balance-sheet before the financing shows bank loans, if the proceeds are to be applied to bank loans actually outstanding at the date of the balance-sheet. Ordinarily, however, the accountant should not apply the proceeds of financing to the payment of current trade accounts payable, at least not against a normal volume of such current accounts payable, because there must always be such accounts outstanding and the application of new moneys against the outstandings at the date of the balance-sheet results in showing a position

which in fact could never be attained. The accountant may usually best satisfy himself that the funds will be applied as indicated by getting an assurance from the issuing house on the point.

III. In any description of a statement or in any certificate relating thereto it is desirable that the past tense should be used; it should also be made clear that the transactions embodied have been definitely covered by contracts.

IV. When the accountant feels that he cannot certify to such a hypothetical statement, probably because of the length of the period which has elapsed since the accounts have been audited, he may be prepared to write a letter, not in certificate form, stating that at the request of the addressee a statement has been examined or prepared in which effect is given, in his opinion correctly, to proposed transactions (which must be clearly specified). Such letters should be given only in very special cases and with the greatest care.

The Rules Exemplified

The committee illustrates the special form of statement and certificate, and also of the letter coming within the terms of rule IV, as follows:

Form of balance-sheet and certificate where conditions laid down in rules I and II have been met

A. B. C. COMPANY
BALANCE-SHEET
DECEMBER 31, 1922

(Giving effect as at that date to the sale of $5,000,000 first mortgage bonds since consummated and the application of the proceeds in part in reduction of liabilities)

Assets
Liabilities

We have examined the books and accounts of the A. B. C. Company for the year ending December 31, 1922, and the agreement dated March 2, 1923, for the sale of $5,000,000. first mortgage bonds, and we certify that the above balance-sheet is, in our opinion, a fair and accurate statement as of December 31, 1922, of the financial position of the company, giving effect at that date to the provisions of the agreement mentioned.

New York,
March 2, 1923.

The committee also presented a form of letter which could come within the terms of the fourth rule:

New York, August 25, 1923.

Mr. John Smith, Vice-president,
A. B. C. Company,
52 William street,
New York.

DEAR SIR:

In accordance with your request, we have examined the attached balance-sheet of the A. B. C. Company as of June 30, 1923, and beg to advise you that in our opinion it is prepared so as to reflect correctly the position of the company as shown by the books, but giving effect as at that date to the pending issue of $300,000. first mortgage bonds as provided in the agreement dated August 25, 1923, and to the extinguishment, out of the proceeds of the new financing, of the notes payable to bankers to the amount of $300,000.

It will be understood that we have not audited the books since the close of the fiscal year on December 31, 1922. You have heretofore been furnished with the audited accounts as of that date, which were in accord with the books.

Yours truly,

Legal Liability of Accountants

One of the things most needed for the welfare and reputation of the accounting profession is swift and vigorous emphasis on legal liability where it belongs. The old question of the responsibility of an auditor for the statements which he makes or for the failure to state matters which he should have included in his report is familiar to every accountant. Unfortunately the number of court decisions in regard to legal responsibility is practically negligible in the United States, and the decisions rendered by British courts, while satisfactory so far as they go, do not go to the point of exactly defining the limits of the accountant's responsibility. They still leave, and probably must always leave, the question of the border line of responsibility to depend upon the opinion of the court or other adjudicator. In regard to the responsibility for actual misrepresentation or fraud, however, there is no room for difference of opinion. Every accountant will welcome court decisions which place the blame for wrongdoing; and if accountants or those who describe themselves as accountants are found to have been guilty of moral turpitude, it is earnestly to be hoped that punishment will be inflicted with the utmost rigor. Every court decision which helps to define responsibility is welcome, and every infliction of penalty where penalty belongs brings nearer realization the Utopian dream of a stainless profession. Of course we do not expect that accountancy will always be free or will ever be free

from charlatanism, and there will doubtless be fraud and wrongdoing until the dawn of the millennium, but it is the duty of every member of the profession to assist in every possible way to ensure the full force and penalty of law where law has been infringed. Recently there have been cases in which so-called accountants have been found guilty of wrongdoing, and the likelihood of punishment is not seriously lessened by appeals which have been taken to higher courts. It is unfortunate, of course, that there must be accusations and that accusations should sometimes be well founded, but all reputable members of the profession must regard with profound gratification everything that helps to clean house.

American Institute of Accountants

Meetings at Washington, D. C., September 17 to 20, 1923

The regular annual meeting of the American Institute of Accountants was called to order at 10 A.M., Tuesday, September 18, 1923, at the Washington Hotel, Washington, D. C., president Edward E. Gore presiding.

Invocation was offered by Dr. John Britton Clarke.

The chair extended a welcome to the representatives of foreign societies of accountants. Responses were made by John B. Niven representing the Society of Accountants in Edinburgh, James A. Gordon representing the Institute of Accountants and Actuaries in Glasgow and Bert R. Masecar representing the Dominion Association of Chartered Accountants. Communications were received from the Institute of Chartered Accountants in England and Wales and from the Society of Incorporated Accountants and Auditors expressing regret that these organizations would not be represented, but wishing the Institute a successful meeting.

Minutes of the annual meeting of 1922, as printed in the year-book and distributed to the members, were approved.

Reports of officers, council, board of examiners and committees were presented either at the meeting of council on September 17th or at the opening session of the general meeting on September 18th. These reports were accepted and ordered printed in the year-book.

An effort to obtain unanimous consent to dispense with voting by proxies was not successful and a committee was appointed to receive and register proxies.

Certain amendments to the constitution and by-laws were adopted. The most important of these provided for filling vacancies caused by the death of officers or members of the council between meetings: for the elimination of "ethical publicity" from the list of committees and the addition of "credentials" and "terminology"; and for striking from the by-laws the provision requiring that two meetings out of three shall be held in the District of Columbia.

A discussion of the relationship between the accountant and the income-tax unit, with particular reference to the 1921 law, was opened by Robert H. Montgomery. At the close of the discussion it was resolved that a special committee be appointed by the chair to act with the commitee on federal legislation having in charge the one duty of bringing out the thought of the membership of the Institute as to what can be done which has not been done in regard to administering the present income-tax law, and to take up the whole question of the contact of the accountant with the bureau of internal revenue, such committee to send out to the membership at large a statement as to the reason of its appointment and asking for specific suggestions, with leave to coöperate with the committees of other organizations having a similar object in view.

The subject of Institute publicity was discussed by Homer S. Pace and others. At the end of the discussion it was resolved that the recommendation made by Mr. Pace relative to the creation of a bureau of public affairs for the Institute and the employment of a necessary staff for the conduct of that bureau be referred to the council with a recommendation that the suggestions be adopted.

It was also moved that the president be authorized to appoint technical committees to deal with special accounting subjects and make investigations, reports and recommendations concerning them.

It was resolved that the Institute give to the work of the Arbitration Society of America its support, that it communicate with members throughout the country urging them to favor the introduction of a system of arbitration in commercial disputes and to do everything possible to forward the popularity of arbitration, including services as arbitrators when called upon for such service.

The election of officers, members of council and members of the committee on nominations resulted as follows:

President: Edward E. Gore

Vice-presidents: Frank Lowson, Norman E. Webster

Treasurer: Arthur W. Teele

Council for five years:

P. L. Billings
James F. Farrell
Lewis G. Fisher
David L. Grey
T. H. Lawrence
Homer S. Pace
W. A. Smith

Committee on nominations:

Elected by council:

James S. Matteson
J. Edward Masters

Elected by Institute:

William B. Campbell
George H. Ford
Alonzo Richardson
T. Edward Ross
Arthur Young

The need for accountants as receivers and trustees was discussed by John B. Niven and others. At the close of the discussion it was resolved that the desirability of furthering the appointment of accountants as receivers and trustees be referred to the council with a recommendation that it adopt all proper means to forward the movement.

The question of a national budget was discussed by Harvey S. Chase, General H. M. Lord, director of the budget, and H. P. Seidemann.

William B. Campbell opened a discussion on the question of coöperation between bankers and accountants and referred to a report

of a special committee which had been presented at the meeting of council. This report contained rules relative to the preparation of statements giving effect to proposed financing. It was resolved that the Institute approve the rules proposed by the report and recommend their adoption for the guidance of members of the Institute.

The application of ethical principles was the next subject of discussion and was opened by Carl H. Nau, chairman of the committee on professional ethics.

Votes of thanks to the committees and to speakers concluded the business of the meeting.

At the annual banquet held at Columbia Country Club on September 19th the toastmaster was Edward E. Gore. The principal speaker was J. Harry Covington, counsel for the American Institute of Accountants.

At the meeting of council held on Monday, September 17th reports of officers and committees were received.

The council adjourned and convened as trial board to hear charges preferred against a member charged with breach of rule 12 of the rules of professional conduct. After hearing the charges and the defense of the member in question it was resolved that he be admonished to abstain from further acts similar to those the subject of complaint.

It was resolved that the name of this member be omitted from the published report.

The trial board adjourned and the council reconvened.

Upon recommendation of the committee on professional ethics some minor changes in the rules of professional conduct were adopted.

At the meeting of council held on Monday, September 17th, reports Richardson was elected secretary.

The following were elected members of the executive committee:

Lewis G. Fisher
F. H. Hurdman
Clifford E. Iszard
Robert H. Montgomery
Frederick A. Ross

The following were elected members of the committee on professional ethics:

Carl H. Nau, *chairman*
John F. Forbes
J. Porter Joplin
J. Edward Masters
Adam A. Ross

Three members of the board of examiners to serve for a term of three years were elected as follows:

John F. Forbes
Charles E. Mather
Waldron H. Rand

The council approved an application for permission to form a California chapter of the Institute.

Upon reference by the chairman of the board of examiners to a report dealing with the question of reciprocity between state boards of accountancy, prepared by a special committee of state examiners, it was resolved that the report should be printed in pamphlet form and distributed to all members of the Institute and to all other members of state boards of accountancy not members of the Institute.

The Colorado Society of Certified Public Accountants

At the annual meeting of the Colorado Society of Certified Public Accountants held September 19, 1923, the following officers and directors were elected: T. R. Young, president; L. C. Linck, first vice-president; F. H. Bentley, second vice-president; George Best, third vice-president; W. J. Thompson, treasurer; J. L. Butler, auditor; T. J. Witting, secretary. The directors are as follows: George Best, W. H. Sprenkel, Clem W. Collins, Louis C. Linck, Ralph B. Mayo, T. R. Young, T. J. Witting, T. H. Redington and F. H. Bentley.

Bert Claude Braman

Bert Claude Braman, member of the American Institute of Accountants, certified public accountant (New York) died September 23, 1923. Mr. Braman had been a member of the American Institute of Accountants since its foundation and was a member of the American Association of Public Accountants which preceded the Institute.

Sparling & Clark announce that Edward P. Tremper has been admitted to partnership in the firm, and that the practice hereafter will be continued under the name of Sparling, Clark & Tremper, with offices in the Central building, Seattle, Washington.

It is announced that the firm of Williams, Benetz & Bourgeois has been reorganized, and will continue practice under the firm name of Thomas A. Williams & Co., with offices in Carondelet building, New Orleans, Louisiana.

J. H. Jorgenson and Lloyd P. Luckham announce the formation of a partnership under the firm name of Jorgenson & Luckham, with offices at 821 Market street, San Francisco, California.

G. Harvey Porter announces the opening of an office in the Lexington building, Baltimore, Maryland.

Samuel W. Webster announces the opening of offices at 136 Liberty street, New York.

Income-tax Department

EDITED BY STEPHEN G. RUSK

Circular No. 230[1], issued by the treasury department under date of August 15th, defining the laws and regulations governing the recognition of attorneys, agents and other persons representing clients and others before that department should make interesting reading to members of the American Institute of Accountants and those in sympathy with it in its efforts to raise the plane of accountancy to the heights which it should occupy as a profession.

We publish in this issue a number of treasury decisions of more than passing interest to which we direct particular attention.

TREASURY RULINGS

DEPARTMENT CIRCULAR NO. 230[1].

Treasury Department,
Office of the secretary,
Washington, August 15, 1923.

The statutes regulating the recognition of attorneys and agents and their practice before the treasury department appear at the end of these regulations.

Pursuant to statutory provisions, the following rules and regulations are prescribed:

1. *Practice.*—Any individual taxpayer or member of a firm or officer or authorized regular employe of a corporation may appear for himself or such firm or corporation solely upon adequate identification to the treasury officials. Where, however, the attorney or agent appears before the department representing a taxpayer, he must be enrolled, and, to be enrolled, must satisfy the requirements of the statute. The statute requires that applicants for enrollment must "show that they are of good character and in good repute, possessed of the necessary qualifications to enable them to render * * * claimants valuable service, and otherwise competent to advise and assist such claimants in the presentation of their cases." (Act of July 7, 1884.) In order better to protect the taxpayer's interests and to expedite practice before the department, applicants should clearly establish their right to enrollment by showing that they possess (1) a good character and reputation; (2) a sound education; and (3) a familiarity with the laws and regulations covering taxes or other subjects which they will present to the department. Practice before the treasury department is not restricted to duly licensed atorneys at law and certified public accountants; but an agent who is not an attorney or accountant, and attorneys and accountants licensed in states where, in the opinion of the committee on enrollment and disbarment, the license requirements are not adequate, must show satisfactory educational qualifications and evidence of an ability to understand tax questions or such other matters as will be presented to the treasury by the applicants. An applicant's

[1] Effective August 15, 1923. This circular supersedes treasury department circular No. 230, dated February 15, 1921, and its several supplements.

character and reputation can only be established by inquiry among those who have had the opportunity of knowing the applicant in the community in which he has lived. A bad reputation as to integrity or any previous conduct of applicant which is unethical, as viewed by the standards of the American Bar Association or the American Institute of Accountants, or such conduct as would be considered unfair in commercial transactions, will be regarded as sufficient to justify the rejection of the application. References as to the applicant's character should be given, and in addition the applicant should furnish the names of those with whom he has come in contact in his business and of whom inquiry may be made. The committee on enrollment and disbarment will endeavor to ascertain all facts deemed necessary by it to pass on any applicant without expense or undue inconvenience to the applicant, but the committee may require, where it is not satisfied with the information received, that the applicant appear in person before the committee or its duly authorized representative.

2. *Applications for enrollment.*—Applicants for enrollment pursuant to these regulations shall submit to the secretary of the treasury an application, in duplicate, properly executed on form 23 attached hereto. Applications in any other form will not be considered, and all statements contained in the application must be verified by the applicant. The application must be accompanied by an affidavit regarding contingent fees, in compliance with the order of the secretary of the treasury dated March 21, 1923, as amended April 7, 1923. The applicant must also take the oath of allegiance and to support the constitution of the United States as required by section 3478, *Revised Statutes.* A person who can not take the oath of allegiance and to support the constitution of the United States can not be enrolled. Members of the bar of a court of record will apply for enrollment as attorneys; all others will apply for enrollment as agents. Applicants will be notified of the approval or disapproval of their applications. All applications for enrollment must be individual, and individuals who practice as partners should apply for enrollment as individuals and not in the partnership name. An individual who has been enrolled may, however, represent claimants and others before the treasury department in the name of a partnership of which he is a member or with which he is otherwise regularly connected. Except as hereinafter provided in paragraph 3, a corporation can not be enrolled and attorneys or agents will not be permitted to practice before the treasury department for account of a corporation which represents claimants and others in the prosecution of business before the treasury department. Persons applying for enrollment who propose to act for such a corporation in the prosecution of claims and other business before the treasury department will be subject to rejection, and enrolled attorneys or agents who act for a corporation in representing claimants and others in the prosecution of claims and other business will be subject to suspension from practice as to such claims or business.

3. *Customhouse brokers.*—The act of June 10, 1910 (36 Stat. 464, T. D. 30789), provides in part that persons, copartnerships, associations, joint-stock associations, and corporations may be licensed as customhouse brokers by the collector or chief officer of customs at any port of entry or delivery to transact business as such customhouse broker in the collection district in which such license is issued. Customhouse brokers so licensed require no further enrollment under these regulations for the transaction of business within their respective collection districts, but for the representation of a claimant before the treasury department in the city of Washington, application for enrollment as attorney or agent must be made in conformity with the requirements of paragraph 2, and otherwise in accordance with these regulations, except that if a customhouse broker, so licensed in a collection district, is a copartnership, association, joint-stock association, or corporation, its claims or other business may be

prosecuted in its name before the department in the city of Washington by an accredited member or representative, who must, however, be first duly enrolled in accordance herewith.

4. *List of attorneys and agents.*—A list of all attorneys and agents who make application for enrollment or who are enrolled or whose applications have been rejected or who have been suspended or disbarred, will be kept in the office of the chief clerk of the treasury department, and a copy of such list will be furnished the bureaus, offices, and divisions of the treasury department. Information as to whether or not any person is enrolled as an attorney or agent may be had by application to the chief clerk. All bureaus, offices, and divisions of the treasury department are prohibited from recognizing or dealing with any attorney or agent unless enrolled, provided that an attorney or agent, by application to the chief clerk and at the discretion of the committee on enrollment and disbarment, may be recognized temporarily, pending action upon his application for enrollment.

5. *Knowledge through connection with the treasury department.*—No attorney or agent shall be permitted to appear before the treasury department in connection with any matter to which such attorney or agent gave personal consideration or as to the facts of which he had actual personal knowledge while in the service of the treasury department, and likewise no such attorney or agent shall aid or assist another in any such matter and no attorney or agent shall receive assistance from one formerly in the service of the treasury department and having such personal knowledge.

6. *Suspension and disbarment proceedings.*—If information is received by the treasury department of conduct of any enrolled attorney or agent in violation of any of the statutory provisions or regulations governing practice before the department, the information shall be referred to the committee on enrollment and disbarment. The committee may, on the basis of any such complaint, upon its own motion, or otherwise upon reasonable cause, institute proceedings for suspension or disbarment against any enrolled attorney or agent. Notice thereof, signed by the secretary or undersecretary of the treasury, shall be sent by mail to such attorney or agent at the address under which he is enrolled, and such notice shall state the charge or charges made, and give the place and time within which the respondent shall file, in duplicate, his verified answer, which time shall be not less than 20 nor more than 30 days from the date of mailing the notice. Such answer shall state specifically every ground of defense relied upon by the respondent to answer the charge or charges against him. The committee may, in its discretion, extend the time for filing such answer. The complainant may, in the discretion of the committee, be furnished with a duplicate copy of such answer. If the respondent fails to file such answer within such time, he shall be declared to be in default and the charge or charges against him shall be deemed to be true without further proof by the complainant. When the answer has been filed, the committee shall pass upon the sufficiency of the same, and in case an issue of fact is raised by said answer, then the committee shall set a time and place for the hearing of such case. Notice of the time and place of such hearing signed by the chairman of the committee, shall be sent by mail to the respondent, which hearing shall not be less than 20 nor more than 30 days from the date of mailing such notice. The committee may, in its discretion, postpone the date of hearing, or adjourn any hearing from time to time as may be necessary. An enrolled attorney or agent against whom proceedings for suspension or disbarment have been instituted as herein provided may, pending the conclusion of the proceedings and subject to the approval of the secretary of the treasury, be suspended for the time being from practice before the treasury department.

The committee shall conduct hearings according to such rules of procedure as it shall determine, and may receive evidence in such form

as it may deem proper. The respondent may be represented by counsel. The testimony of witnesses may, in the discretion of the committee, be required to be under oath, and may be stenographically reported and transcribed. Depositions for use at a hearing may, with the approval of the committee, be taken by either party upon oral or written interrogatories before any officer duly authorized to administer an oath for general purposes upon 10 days' written notice if the deposition is to be taken within the District of Columbia and upon 20 days' written notice if it is to be taken elsewhere. When a deposition is taken upon written interrogatories, any cross-examination shall be upon written interrogatories. Copies of such written interrogatories shall be served with the notice, and copies of any written cross-interrogatories shall be mailed to the opposing party or his counsel at least five days before the time of taking the deposition.

The committee shall, promptly after the conclusion of the hearing, or, if the respondent does not appear in person for the hearing, promptly after the date set therefor, submit to the secretary of the treasury a copy of the notice of hearing, the complaint, answer (if any), the record of the hearing (if any), and any written findings of fact by a majority of the committee, together with a recommendation either that the charges be dismissed or that the respondent be reprimanded, suspended for a given period of time or disbarred. The findings and recommendation shall be signed by all members of the committee agreeing thereto. Members of the committee dissenting therefrom shall submit statements of their reasons therefor. If any members of the committee were not present at the hearing, the fact shall be stated.

Upon the suspension or disbarment of an attorney or agent, notice thereof shall be given by the committee to the heads of all bureaus, offices, and divisions of the treasury department and to the other branches of the government, and, unless duly reinstated, such person shall not thereafter be recognized as an attorney or agent in any claim or other matter before the treasury department or any office thereof.

7. *Causes for rejection, suspension, or disbarment.*—In general, any conduct which would preclude an applicant from enrollment will be sufficient to justify his suspension or bisbarment. Specifically, the following matters, among others, will be considered grounds for suspension or disbarment:

(a) Violation of the statutes or rules governing practice before the treasury department.

(b) Conduct contrary to the canons of ethics as adopted by the American Bar Association, or the rules of professional conduct approved by the American Institute of Accountants, or their equivalent.

(c) False or misleading statements or promises made by the attorney or agent to a taxpayer or misrepresentation to the treasury department.

(d) Solicitation of business by the attorney or agent. This includes letters, circulars, and interviews not warranted by previous association; printed matter appearing on the letterheads or cards of the attorney or agent indicating previous connection with the treasury department or enrollment as attorney or agent; or representation of acquaintance with treasury officials or employes. It includes also the use by attorneys and agents of any titles which might imply official status or connection with the government, such as "federal tax expert" or "federal tax consultant." It is not considered a violation of this regulation for treasury employes, on severing their connection with the department, to send out announcement cards, briefly stating their former official status and announcing their new association, provided the cards are addressed only to personal or business acquaintances, and provided further that such cards are distributed only at the time of severance of the official connection with the government. These cards are regarded by the committee not as advertising but as the customary announcement cards issued for the express purpose of identifying the sender with his new association or business.

(e) Negligence in furnishing evidence required in matters pending before the treasury department, and the use of any means whereby the final settlement of the matter is unjustifiably delayed.

(f) The employment by an enrolled attorney or agent as correspondent or subagent in any matter pending before the treasury department, or the acceptance by such enrolled attorney or agent of employment as correspondent or subagent of or from any person who has been denied enrollment or who has been suspended or disbarred from practice. It is in violation of the regulation for an enrolled attorney or agent to assist in any way or be assisted by an attorney or agent who has been denied enrollment or has been suspended or disbarred.

(g) Any other matter which, in the opinion of the committee on enrollment and disbarment, is unfair to the taxpayer or to the treasury department or interferes unduly with the orderly disposition of matters pending before the department.

8. *Contingent fees.*—(a) While contingent fees may be proper in some cases before the department, they are not generally looked upon with favor and may be made the ground of suspension or disbarment. Both their reasonableness in view of the services rendered and all the attendant circumstances are a proper subject of inquiry by the department. The commissioner of internal revenue or the head of any other treasury bureau or division of the secretary's office may, at any stage of a pending proceeding, require an attorney or agent to make full disclosure as to what inducements, if any, were held out by him to procure his employment and whether the business is being handled on a contingent basis, and, if so, the arrangement regarding compensation. The treasury department will also make such independent inquiry in regard to the circumstances connected with the employment of attorneys or agents on a contingent basis as it deems advisable.

(b) All attorneys and agents and others practicing before the treasury department or any of its bureaus or offices are required to file with the chief clerk of the treasury department an affidavit, in duplicate, stating whether or not the business in which the attorney or agent appears before the department is being handled on a contingent basis, and, if so, on what basis and under what arrangements regarding compensation. Specific information, giving the names and descriptions of cases handled on a contingent basis, must be filed covering all such cases pending before the treasury department; and, whenever an additional case is taken on the basis of a contingent interest or fee, a further affidavit regarding such case must be filed with the department, provided, however, that any attorney or agent not practising before the department on a contingent basis may file with the chief clerk of the treasury department, in lieu of these specific affidavits, a general affidavit, in duplicate, stating that he is not handling any business before the treasury department on a contingent basis and that he will not handle any business before the treasury department on a contingent basis without first giving specific notice to the department and filing an affidavit in duplicate, as above required. Every such affidavit must state the treasury offices before which the attorney or agent proposes to practise.

(c) The chief clerk of the treasury department will retain in his confidential files the originals and duplicates or copies of all such affidavits regarding contingent fees for use of the committee on enrollment and disbarment and of heads of bureaus and divisions. While discouraging contingent feets and requiring their disclosure, the treasury does not bar such fees in practice before the treasury department; nor is the information, which is submitted in connection with such cases, used to prejudice the fair consideration of any case, provided the attorney or agent is guilty of no unfair practice or violation of the treasury's requirements.

(d) All attorneys and agents practising before the treasury department, who have filed specific or general affidavits regarding contingent fees, will be furnished with cards showing that they have done so, and officers of the department will recognize only those presenting such cards, which will be accepted in lieu of all cards previously issued to them as evidence of their authority to practice before the department. These cards are issued on condition that, prior to appearing before the department in any case handled on the basis of a contingent interest or fee, the said case shall be reported to the department as hereinbefore provided.

9. *Constitution of committee.*—The committee on enrollment and disbarment shall consist of the chief clerk of the treasury department, ex officio, and five other members appointed by the secretary of the treasury, of whom two shall be detailed from the office of the secretary, two from the office of the commissioner of internal revenue and one from the division of customs. The secretary shall designate the chairman and vice-chairman from members detailed from his office. The committee shall make such rules for its own government as it considers advisable. Subject to these regulations, the committee shall have jurisdiction over all matters relating to enrollment, suspension, or disbarment of attorneys and agents practising before the treasury department, and shall submit its recommendations to the secretary of the treasury for approval.

10. *Authority to prosecute claims; delivery of cheques, drafts, and warrants.*—(a) A power of attorney from the principal in proper form may be required of attorneys or agents by heads of bureaus, offices, and divisions, in any case. *In the prosecution of claims involving payments to be made by the United States, proper powers of attorney shall always be filed before an attorney or agent is recognized.* No power of attorney shall be recognized which is filed after settlement made by the accounting officers, even though the settlement certificate may not yet have issued, unless such power of attorney recites that the principal is fully cognizant of such settlement and of the balance found due.

(b) In all cases originally filed in the treasury department and audited and allowed by the accounting officers, payable from appropriations thereafter to be made by congress, the drafts warrants or cheques issued for the proceeds of such claims shall be made to the order of the claimant, and may be delivered to the attorney or agent legally authorized to prosecute the same, upon his filing in the department, after the allowance of the claim, the ascertainment of the amount due, and its submission to congress for an appropriation, written authority executed in proper legal form for delivery of such draft, warrant, or cheque. The authority so filed shall describe the claim by the number of certificate of settlement, the amount allowed, the title of appropriation from which to be paid, the date when submitted to congress, and the number of the executive document in which it is contained. Drafts, warrants, or cheques issued for the proceeds of other like cases audited and allowed by the accounting officers but which are to be paid from appropriations available at the time of allowance shall also be made to the order of the claimant and may be delivered to the attorney or agent filing written authority, executed in proper legal form, to receive them. The secretary of the treasury reserves the right, however, in any case to send any draft, warrant, or cheque to the claimant direct. (See also paragraph 11 hereof.)

(c) Drafts, warrants, or cheques issued in payment of amounts allowed by congress in favor of corporations and individuals and appropriated for in private or special acts, and for the payment of all other claims presented directly to congress and prosecuted before its committees, shall be made to the order of claimants and delivered to them in person or mailed to their actual post-office addresses.

(d) Drafts, warrants, or cheques issued in payment of judgments rendered by the court of claims, United States courts, or other courts

shall be made to the order of the judgment creditor and delivered to or sent in care of the attorney certified by the court to be the attorney of record upon his filing in the department written authority, executed in proper legal form, after the date of the rendition of the judgment, for such disposition of such draft, warrant, or cheque.

(e) When judgments of the court of claims, United States courts, or other courts are paid by the United States, a notice of such payment, giving number, class, and date of draft, warrant or cheque, and amount paid, will be sent by the treasury department to the clerk of the court in which the judgment was entered in order that payment may be entered on the docket of the court.

11. *Substitution of attorneys or agents and revocation of authority.*— (a) Substitution of attorneys or agents may be effected only on the written consent of the attorney or agent of record, his principal, and the attorney or agent whom it is desired to substitute, and in all cases only with the assent of the head of the bureau, office, or division concerned; provided that where the power of attorney under which an attorney or agent of record is acting expressly confers the power of substitution, such attorney or agent, if in good standing before the department, may, by a duly executed instrument, substitute another in his stead, such other, however, to be recognized as the attorney or agent only with the assent of the head of the bureau, office, or division concerned.

(b) If a firm dissolve, or those associated as attorneys or agents by virtue of a power of attorney contest the right of either to receive a draft, warrant or cheque, the principal only shall thereafter be recognized, unless the members or survivors of such firm, or the associates in such power of attorney, file a proper agreement showing which of such members, survivors or associates may continue to prosecute the matter and may receive a draft, warrant or cheque; and in no case shall a final settlement of the matter or action toward the transmission of a draft, warrant or cheque to the principal be delayed more than sixty days by reason of the failure to file such agreement.

(c) The revocation by a principal or his legal representatives of authority to prosecute a matter will not be effective so far as the treasury department is concerned, without the assent of the head of the bureau, office or division before which the matter is pending. Where a matter has been suspended pending the furnishing of evidence for which a call has been made on an attorney or agent, failure to take action thereon within three months from the date of suspension may be deemed by the administrative officer before whom the case is pending cause for revocation of the authority of such attorney or agent without further notice to him.

(d) In the settlement of claims of officers, soldiers, sailors and marines, or their representatives, and all other like claims for pay and allowances within the jurisdiction of the general accounting office, the draft, warrant or cheque for the full amount found due shall be delivered to the payee in person or sent to his bona fide post-office address (residence or place of business) in accordance with the provisions of the act of June 6, 1900 (31 Stat., 637).

12. *Acknowledgment of affidavit.*— A declaration, affidavit, or any paper, requiring execution or acknowledgment in connection with any claim, application for reaudit, or other matter before the treasury department, must be executed or acknowledged before an officer duly authorized to administer oaths for general purposes who is not interested in the prosecution of the claim or other matter to which the said declaration, affidavit, or paper pertains.

13. *Application and effective date of circular.*—This circular supersedes the regulations promulgated by treasury department circular No. 230 of February 15, 1921, as heretofore amended and supplemented, relating to the recognition of attorneys, agents, and others. The regulations con-

tained in this circular shall apply to attorneys, agents, and others representing claimants and others before the treasury department in the city of Washington or elsewhere, with the exception as to customhouse brokers set forth in paragraph 3, and shall be effective from and after the 15th day of August, 1923. This circular shall apply to all unsettled matters then pending in this department, or which may hereafter be presented or referred to the department or offices thereof for adjudication, and shall be applicable to all those now enrolled to practise before the treasury department as attorney or agent, provided that nothing herein contained shall be construed to abrogate any rules or orders of the general accounting office relating to the fees of attorneys, agents, or others, or to require those now enrolled to apply again to be enrolled.

14. *Circular may be withdrawn or amended.*—The secretary of the treasury may withdraw or amend at any time or from time to time all or any of the foregoing rules and regulations, with or without previous notice, and may make such special orders as he may deem proper in any case.

A. W. MELLON,
Secretary of the Treasury.

(T. D. 3501—July 23, 1923)

Federal taxes—Bankruptcy—Decision of court.

1. BANKRUPTCY—FEDERAL TAX—PRIORITY—LABOR CLAIMS.

Under the provisions of sections 64-a and 64-b of the bankruptcy act a claim for federal taxes takes priority over payment of labor wage claims where the assets of the estate are insufficient to pay all claims in full.

2. CASES DISTINGUISHED AND FOLLOWED.

Richmond v. Bird (249 U. S. 174), distinguished; *Guarantee Co. v. Title Guaranty Co.* (224 U. S. 152); In re *Weissman* (178 Fed. 115); and In re *Kittenplan* (285 Fed. 82), followed.

The attached decision of the United States circuit court of appeals for the ninth circuit in the case of *West Coast Rubber Corporation (Inc.), bankrupt et al. v. A. J. Oliver, trustee et al.*, is published for the information of internal-revenue officers and others concerned.

UNITED STATES CIRCUIT COURT OF APPEALS, NINTH CIRCUIT

In the matter of West Coast Rubber Corporation, Inc., a corporation, bankrupt; United States and the City and County of San Francisco, a municipal corporation, petitoners, v. A. J. Oliver, as trustee, and Oscar Courtin, Dorothy E. Knight, C. S. Sanford, D. C. Tuhey, H. Black, and Hugh V. Casserly, respondents.

Before GILBERT, HUNT and RUDKIN, Circuit Judges.

[July 2, 1923]

GILBERT, circuit judge: This case, on petition for revision, presents the question of the relative order of priority between tax claims and labor claims in the distribution of an estate in bankruptcy, the assets being insufficient to pay all such claims in full. It involves the construction of sections 64-a and 64-b of the bankruptcy act. 64-a directs the court to order payment of—

> all taxes legally due and owing by the bankrupt to the United States, state, county, district, or municipality in advance of the payment of dividends to creditors.

64-b provides:

> The debts to have priority except as herein provided and to be paid in full out of bankrupt's estates shall be (after payment of costs of preserving the estate, filing fees and costs of administrations) (4) Wages of workmen, etc. Wages due to workmen, clerks, traveling or city salesmen or servants which have been earned within three months

before the date of commencement of proceedings, not to exceed three hundred dollars to each claimant.

The court below held that the claim for wages was prior in rank to taxes owing by the bankrupt. In support of that ruling, reference is made to the language of section 64-a in which the taxes are directed to be paid before the payment of dividends to creditors, and it is said that as "dividends to creditors" means partial payments to general creditors, and payment of taxes is directed to be paid prior to the payment of such dividends only, the intention was to give priority to all the preferred claims mentioned in 64-b. It is true that the term "dividends to creditors" ordinarily refers to dividends to general creditors. But it does not necessarily have that meaning. A dividend is that which is to be divided. In bankruptcy it is the sum of money which is to be divided among two or more creditors. It is not necessarily a partial payment. It is obvious that it may at times be a payment in full even as to general creditors. We think it is the intention of 64-a to provide that taxes shall be paid before any payment is made to creditors, whether they be general creditors or preferred creditors. The power to levy and collect taxes is not only an indispensable attribute of sovereignty, but it is absolutely necessary to the support of government, the maintenance of law and order, and the protection of life and property. It is not to be supposed that the power to tax would be subordinated to the claim of any creditor, however meritorious that claim may be. In the bankruptcy act of 1867 this was not left to doubt. The law made it clear that after the payment of costs, fees, and expenses, all debts due the United States and all taxes and assessments under both the laws of the United States and the states should be paid, and thereafter wages for services performed within a stated period prior to bankruptcy.

The court below found authority for its ruling in *Richmond v. Bird* (249 U. S. 174) in which the court said:

> Section 64-a directs that taxes be paid in advance of dividends to creditors, and "dividends" as commonly used throughout the act means partial payment to general creditors.

We do not find that the court was there dealing with the question which is involved in this case. That was a case in which the city of Richmond sought to have taxes declared payable out of the bankrupt's assets in preference to the claim of a landlord which was secured by a specific lien arising upon distraint. The court held that the city had no such superior right since neither the laws of the United States nor those of the state accorded it such priority. In *Richmond v. Bird* no reference was made to *Guarantee Co. v. Title Guaranty Co.* (224 U. S. 152). In the latter case the court had said:

> Labor claims are given priority and it is provided that debts having priority shall be paid in full. The only exception is taxes legally due and owing by the bankrupt to the United States, state, county, district, or municipality.

It is objected that what was thus said was obiter, but conceding that it may have been unnecessary to the decision of the question then pending before the court, it should nevertheless be taken as the expression of the view of the court upon the question of the relative rank of taxes and labor claims, and we do not find that it is inconsistent with or that it is met or answered by anything that was held or said in *Richmond v. Bird*.. In harmony with the conclusion which we reach are In re *Weissman* (178 Fed. 115) and In re *Kittenplan* (285 Fed. 62).

The petitioner discusses also the question whether penalties are allowable as part of the taxes, but that question is not properly before us, the court below not having ruled upon it, and it appearing that the referee in bankruptcy, on a hearing had before him later than the hearing which

is herein sought to be revised, had fixed the amount of taxes and that no review has been taken of his order.

That order is reversed.

(T. D. 3510—September 4, 1923)

Payment of income and profits taxes.

Instructions as to acceptance of treasury notes for income and profits taxes.

1. Collectors of internal revenue are authorized and directed until further notice to receive at par with an adjustment of accrued interest, in payment of income and profits taxes payable at or within six months before their respective maturities, treasury notes of the United States of series A-1924, dated June 15, 1921, maturing June 15, 1924; series B-1924, dated September 15, 1921, maturing September 15, 1924; series A-1925, dated February 1, 1922, maturing March 15, 1925; series B-1925, dated June 15, 1922, maturing December 15, 1925; series C-1925, dated December 15, 1922, maturing June 15, 1925; series A-1926, dated March 15, 1922, maturing March 15, 1926 series B-1926, dated August 1, 1922, maturing September 15, 1926; series A-1927, dated January 15, 1923, maturing December 15, 1927; and series B-1927, dated May 15, 1923, maturing March 15, 1927. Collectors are authorized to receive treasury notes which are acceptable as herein provided in payment of income and profits taxes in advance of the respective tax-payment dates. All matured coupons attached to the notes must be detached by the taxpayer before presentation to the collector, and collected in ordinary course when due, but all coupons that have not matured must be attached to the notes when presented. The amount at par of the treasury notes thus presened by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors shall in no case pay interest on the notes or accept them for any amount other or greater than their face value. Accrued interest from the last interest payment date on any notes accepted to the tax payment date will be remitted to the taxpayer by the federal reserve bank with which the collector makes a deposit on the basis of schedules to be furnished by the collector to the federal reserve bank. Receipts given by collectors to taxpayers should show the amount and description of the notes received in payment of taxes.

2. Deposits of treasury notes received in payment of income and profits taxes hereunder must be made by collectors, unless otherwise specifically instructed by the secretary of the treasury, with the federal reserve bank of the district in which the collector's head office is located, or in case such head office is located in the same city with a branch federal reserve bank, with such branch federal reserve bank. Specific instructions may be given to collectors by the secretary of the treasury in special cases for deposit with federal reserve banks of other districts or branch federal reserve banks. The term "federal reserve bank," where it appears herein, unless otherwise indicated by the context, includes branch federal reserve banks. Treasury notes accepted hereunder by collectors in advance of the tax payment date should be forwarded by the collector to the federal reserve bank to be held for account of the collector until the tax date, and for deposit on such date.

3. Treasury notes accepted hereunder should in all cases be indelibly stamped by the collector on the face thereof as follows, and when so stamped should be delivered to the federal reserve bank in person if the collector is located in the same city, and in all other cases forwarded by registered mail, uninsured:

....., 192...

This note has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

.....

Collector of internal revenue
for the.....district of.....

Each unmatured coupon attached to each such note must be indelibly stamped across the face by the collector with the word "paid," followed by his name and title.

4. Collectors should make in tabular form a schedule in duplicate of the treasury notes to be forwarded to the federal reserve bank, showing, by series, the face amount transmitted, the serial number of each note, the denomination, and the name and address of the taxpayer presenting the note. Notes accepted in advance of the tax payment date must be scheduled separately, and treasury notes should in all cases be scheduled separately from treasury certificates of indebtedness. At the bottom of each schedule there should be written or stamped, "income and profits taxes, $.....," which amount must agree with the total shown on the schedule. One copy of this schedule must accompany notes sent to the federal reserve bank, and the other be retained by the collector. The income and profits tax deposits resulting from the deposits of such notes must in all cases be shown on the face of the certificate of deposit (form 15) separate and distinct from the item of miscellaneous internal revenue collections (formerly called ordinary). Until certificates of deposit are received from the federal reserve banks, the amounts represented by the treasury notes forwarded for deposit must be carried by collectors as cash on hand or in banks, and not credited as collections, as the dates of certificates of deposit determine the dates of collections.

5. For the purpose of saving taxpayers the expense of transmitting such notes as are held in federal reserve cities or federal reserve branch bank cities to the office of the collector in whose district the taxes are payable, taxpayers desiring to pay income and profits taxes by treasury notes should communicate with the collector of the district in which the taxes are payable and request from him authority to deposit such notes with the federal reserve bank in the city in which the notes are held. Collectors are authorized to permit deposits of treasury notes in any federal reserve bank with the distinct understanding that the federal reserve bank is to issue a certificate of deposit in the collector's name covering the amount of the treasury notes at par and to state on the face of the certificate of deposit that the amount represented thereby is in payment of income and profits taxes. The federal reserve bank should forward the original certificate of deposit to the treasurer of the United States, with its daily transcript, and transmit the duplicate to the commissioner of internal revenue, accounts and collections unit, Washington, D. C., and the triplicate to the collector, accompanied by a statement giving the name of the taxpayer for whom the payment is made, in order that the collector may make the necessary record.

(T. D. 3511—September 6, 1923)

Income tax—Cooperative associations.

Article 522 of regulations 62 amended.

Article 522 of regulations 62 is hereby amended to read as follows:

ART. 522. *Coöperative associations.*—(a) Coöperative associations, acting as sales agents for farmers, fruit growers, live-stock growers, dairymen, etc., or engaged in the marketing of farm products, and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the produce furnished by them, are exempt from income tax, and shall not be required to file returns. Thus coöperative dairy companies, which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the statute and is not exempt. The accumulation and

maintenance of a reasonable reserve for depreciation or possible losses or a reserve required by the state statute or a reasonable sinking fund or surplus to provide for the erection of buildings and facilities required in business, or for the purchase and installation of machinery and equipment, or to retire indebtedness incurred for such purposes will not destroy the exemption. A corporation organized to act as a sales agent for farmers, or to market coöperatively the products of the farm, and having a capital stock on which it pays a dividend not exceeding the legal rate of interest in the state in which it is incorporated and in which substantially all of the outstanding capital stock is owned by actual producers, will not for such reasons be denied exemption, but any ownership of stock by others than actual producers who market their products through the association must be satisfactorily explained in the application for exemption. In every such case the association will be required to show that the ownership of its capital stock has been restricted as far as possible to actual producers, and that the association has not voluntarily sold or issued any stock to nonproducers. Thus, if by statutory requirement all officers of an association must be stockholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a stockholder for any reason ceases to be a producer and the association is unable, because of a constitutional inhibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that, under such circumstances, a small amount of the outstanding capital stock is owned by stockholders who are no longer producers will not destroy the exemption.

(b) Coöperative associations organized and operated as purchasing agents for farmers, fruit growers, live-stock growers, dairymen, etc., for the purpose of buying supplies and equipment for their use and turning over such supplies and equipment to them at actual cost, plus necessary operating expenses, are also exempt. The provisions of paragraph (a) relating to a reserve, sinking fund or surplus, and to capital stock, shall apply to associations coming under this paragraph.

In order to be exempt under either (a) or (b) an association must establish that it has no net income for its own account, other than that reflected in a reserve, sinking fund, or surplus specifically authorized in paragraph (a). An association acting both as a sales and a purchasing agent is exempt if as to each of its functions it meets the requirements of the statute.

(T. D. 3512—September 6, 1923)

Payment of income and profits taxes.

Instructions as to cancelation and transmittal of treasury notes and treasury certificates of indebtedness accepted for income and profits taxes.

1. Referring to instructions heretofore issued to collectors of internal revenue and others concerned with respect to the acceptance of treasury notes and treasury certificates of indebtedness in payment of income and profits taxes, attention is directed to the requirements therein set forth governing the cancelation and transmittal of such notes and certificates. These requirements are as follows:

2. Deposits of treasury notes and treasury certificates of indebtedness received in payment of income and profits taxes must be made by collectors, unless otherwise specifically instructed by the secretary of the treasury, with the federal reserve bank of the district in which the collector's head office is located, or in case such head office is located in the same city with a branch federal reserve bank, with such branch federal reserve bank. Specific instructions may be given to collectors by the secretary of the treasury in special cases for deposit with federal reserve banks of other districts or branch federal reserve banks. The term "federal reserve bank," where it appears herein, unless otherwise indicated by the context, includes branch federal reserve banks.

3. Notes and certificates acceptable in payment of income and profits taxes should in all cases be indelibly stamped on the face thereof as follows by the collector, and when so stamped should be delivered to the federal reserve bank in person, if the collector's head office is located in the same city, and in all other cases forwarded by registered mail uninsured:

....., 192...

This note/certificate has been accepted in payment of income and profits taxes and will not be redeemed by the United States except for credit of the undersigned.

.....

Collector of internal revenue
for the.....district of.....

4. Each unmatured coupon attached to such note or certificate must be indelibly stamped across the face by the collector with the word "paid," followed by his name and title.

5. Collectors should make in tabular form a schedule, in duplicate, of the notes or certificates of indebtedness to be forwarded to the federal reserve bank, showing by series the face amount transmitted, the serial number of each note or certificate, the denomination, and the name and address of the taxpayer presenting the notes or certificates. Notes or certificates accepted in advance of the tax date must be scheduled separately, and treasury notes should in all cases be scheduled separately from treasury certificates of indebtedness. At the bottom of each schedule there should be written or stamped, "income and profits taxes $....," which amount must agree with the total shown on the schedule. One copy of this schedule must accompany notes or certificates of indebtedness sent to the federal reserve bank, and the other copy retained by the collector.

6. The foregoing instructions will continue in effect with respect to treasury notes or treasury certificates of indebtedness delivered to the federal reserve bank in person, rather than by registered mail, where the collector's head office and the federal reserve bank are located in the same city.

7. Where the collector's head office and the federal reserve bank are not located in the same city, and it is necessary to transmit the notes or certificates to the federal reserve bank by registered mail uninsured, the following requirements, with respect to the preparation of shipments, must be observed: The notes or certificates, and each unmatured coupon attached thereto, must in all cases be stamped on the face thereof as indicated in paragraphs 3 and 4 hereof. The schedule of securities transmitted should be prepared as prescribed in paragraph 5 hereof, except that it should be prepared in *triplicate*. The original copy of such schedule should be forwarded to the Federal reserve bank by *separate* registered mail, and should bear a certificate signed by two employes of the office of the collector, stating (a) that they inspected and checked the shipment before sealing; (b) that each note or certificate listed was properly canceled by stamping on the face thereof the prescribed legend; (c) that each unmatured coupon attached thereto was stamped "paid" on its face; (d) that the shipment was sealed in their presence before it left their immediate control; and (e) that each and every security listed was in the package when mailed. The duplicate copy of the schedule should be inclosed with the securities, and the triplicate retained by the collector. It is important that the collector's retained copy be carefully preserved, and in this connection it is recommended that the certificate of the two employes be entered also on the retained copy, in order that no complication may arise in the event that the original copy should be lost or destroyed.

8. The foregoing instructions shall apply also to shipments of any obligations of the United States which collectors of internal revenue may hereafter be authorized to accept in payment of income and profits taxes.

9. This treasury decision amends articles 1732 of regulations 62 and T. D. 3421 and T. D. 3510.

(T. D. 3513—September 7, 1923)
Estate or inheritance taxes.

Receipt of Liberty bonds, treasury bonds, and treasury notes in payment estate and inheritance taxes.

The appended department circular, issued under date of July 31, 1923, with reference to receipt of treasury bonds of the United States in payment of federal estate and inheritance taxes, is published for the information of internal-revenue officers and others concerned. This circular supplements department circular No. 225, dated January 31, 1921 (T. D. 3144), as supplemented by department circular dated June 30, 1922 (T. D. 3383).

1. The provisions of the department circular No. 225, dated January 31, 1921, prescribing regulations covering the receipt of liberty bonds and victory notes for federal estate or inheritance taxes, are hereby extended and made applicable to treasury notes of the United States now or hereafter issued under authority of section 18 of the second liberty bond act, as amended and supplemented, bearing interest at a higher rate than 4 per cent. per annum, and any such treasury notes shall accordingly be receivable by the United States at par and accrued interest in payment of any estate or inheritance taxes imposed by the United States, under or by virtue of any present or future law, upon the same terms and conditions as provided in said department circular No. 225, dated January 31, 1921, with respect to the acceptance of liberty bonds and victory notes bearing interest at a higher rate than 4 per cent. per annum.

2. The issues of treasury notes at this date outstanding, bearing interest at a higher rate than 4 per cent. per annum, are:

Description.	Date of issue.	Short title.
(a) 5¾ per cent. notes, payable June 15, 1924	June 15, 1921	Series A-1924
(b) 5½ per cent. notes, payable Sept. 15, 1924	Sept. 15, 1921	Series B-1924
(c) 4¾ per cent. notes, payable Mar. 15, 1925	Feb. 1, 1922	Series A-1925
(d) 4¾ per cent. notes, payable Mar. 15, 1926	Mar. 15, 1922	Series A-1926
(e) 4⅜ per cent. notes, payable Dec. 15, 1925	June 15, 1922	Series B-1925

3. For the calculation of accrued interest on the current coupons of treasury notes tendered in payment of estate or inheritance taxes under this circular, the method outlined in exhibit B to department circular No. 225, dated January 31, 1921, should be followed. Interest tables at the various rates borne by treasury notes may be obtained from the treasury department, division of loans and currency, Washington. The interest tables appropriate for use in connection with the issues of treasury notes at present outstanding are as follows:

Form General 1017, for series A-1924 (interest dates June 15 and December 15).

Form General 1016, for series B-1924 (interest dates March 15 and September 15).

Form L. & C. 369, for series A-1925 prior to September 15, 1922 (interest during this period is on annual 365-day basis).

Form L. & C. 435, for series A-1925 subsequent to September 15, 1922 (interest dates March 15 and September 15).

Form L. & C. 435, for series A-1926 (interest dates March 15 and September 15).

Interest tables or decimals for computing interest as may be required for other or future issues may be obtained from the treasury department, division of loans and currency, Washington, upon request.

(T. D. 3514—September 7, 1923)

Estate tax—Revenue act of 1916 as amended—Decision of court.

DEDUCTIONS—MARYLAND COLLATERAL INHERITANCE TAX.

The Maryland collateral inheritance tax is not an inheritance tax but an estate tax and in computing the federal estate tax is deductible from the gross estate under the provisions of title II of the revenue act of 1916 (as amended by the act of October 3, 1917).—Judgment of the district court (276 Fed. 845) affirmed.

The following decision of the United States circuit court of appeals for the fourth circuit in the case of *Joshua W. Miles, former collector of internal revenue for the United States in and for the district of Maryland and Delaware, v. John J. Curley, John M. Dennis, and William A. Dixon, executors of the last will and testament of Helen M. H. Grafflin, deceased,* affirming the decision of the United States district court for the district of Maryland, is published for the information of internal-revenue officers and others concerned.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

Joshua W. Miles, former collector of internal revenue for the United States in and for the district of Maryland and Delaware, plaintiff in error, v. John J. Curley, John M. Dennis, and William A. Dixon, executors of the last will and testament of Helen M. H. Grafflin, late of Baltimore County, deceased, defendants in error.

WRIT of error to the district court of the United States for the district of Maryland.

(July 3, 1923.)

MCCLINTIC, district judge: The defendants in error (hereinafter called the plaintiffs) brought an action at law in the district court of Maryland to recover a certain sum of money paid to the collector of internal revenue for the district of Maryland and Delaware, being the amount of certain federal estate taxes assessed by the collector on the estate of Helen M. H. Grafflin, who died a resident of Maryland, which sum was claimed by the plaintiffs to be in excess of the amount lawfully chargeable thereon. Such sum of money had been paid under protest, and all proper steps had been taken to bring such action for the recovery thereof.

The taxes were assessed and collected by such collector (hereafter called the defendant) under the provisions of the act of congress approved September 8, 1916, as amended by the act approved March 3, 1917.

The executors claimed a deduction from the total taxable estate of $48,759.44 paid to the state of Maryland as an estate tax. The collector claimed that the deduction was not proper because the tax under the laws of Maryland was a legacy tax.

The defendant interposed a demurrer to the declaration which was overruled.

By stipulation it was agreed that there was no dispute as to the facts alleged in the declaration, and the court being of opinion that the law was with the plaintiffs, a final judgment was entered therein on the 26th day of April, 1922, for the plaintiffs and against the defendant for the sum of $3,710.25 and $26.05 costs.

There is but one question in this case, and that is, does the Maryland collateral inheritance tax attach to an estate before distribution? If so, the plaintiffs are entitled to recover the amount above named.—*Lederer v. Northern Trust Co.* (262 Fed. 253 U. S. 487). (T. D. 3027.)

If, on the other hand, the Maryland tax is a legacy tax and not an estate tax, the sum in controversy was properly collected.—*New York Trust Co. v. Eisner* (256 U. S. 345). (T. D. 3267.)

The decision by the highest court of Maryland directly deciding this question and construing the statute imposing such collateral inheritance tax would be binding upon this court. Is there any such decision?

In discussing this question the learned district judge, in his opinion overruling the demurrer to the declaration herein, says:

> In the case at bar each side has argued that the court of appeals of this state has interpreted the act in the sense for which it contends, and each quotes language which, if standing alone, might sustain its position. That each is able to do so is perhaps the best proof that the attention of that high court never had been drawn to the precise point now at issue, in such sense, at least, as to call for its definite determination.

We have examined the cases decided by the court of appeals of Maryland and referred to in the briefs of counsel and have reached the conclusion that no decision upon this point has been really made.

The Pennsylvania statute upon the subject of collateral inheritance tax is believed to be the first that was passed by any state in America. This statute was enacted in 1826.

In 1884 the legislature of the state of Maryland in substance and effect adopted the Pennsylvania statute.

In the case of *Jackson v. Myers* (257 Pa. 104) the supreme court of Pennsylvania decided that the collateral inheritance tax of Pennsylvania is not levied upon the inheritance or legacy but upon the estate of the decedent, holding that what passes to the legatee is simply the portion of the estate remaining after the state has been satisfied by receiving he tax.

An examination of other cases in that state shows that this case only follows the previous holdings on this subject.

The question presented herein for decision was directly presented to the circuit court of appeals of the third circuit in the case of *Lederer v. Northern Trust Co.*, supra, and that case held that under the Pennsylvania statute and the decisions of the court of last resort in the state of Pennsylvania such tax was an estate tax and not a legacy tax, and that the plaintiff therein should recover from the collector the amount so paid under protest.

Upon the authority of that case and under all the circumstances and conditions surrounding this case we hold that the proper construction of the collateral inheritance statute of Maryland makes such tax an estate tax and not a legacy tax, and therefore the judgment below is affirmed.

B. F. McMorris and John C. McDavid announce the formation of a partnership under the firm name of McMorris-McDavid & Co., with offices at 1533 Boatmen's Bank building, St. Louis, Missouri.

Frank L. Wilcox and N. A. Flood announce the formation of a partnership under the firm name of Wilcox & Flood, with offices at 709 Liberty National Bank building, Waco, Texas.

Roy T. Bell, Charles S. Alverson and Ralph F. Mateer announce the formation of a partnership under the firm name of Roy T. Bell & Co., with offices in the Wick building, Youngstown, Ohio.

Students' Department

EDITED BY H. A. FINNEY

In the May, 1923, examination of the American Institute of Accountants, appeared a problem in the consolidation of three corporations. This problem and a solution thereof were published in the *Students' Department* of July, 1923. The solution is an algebraic one, and the editor made the following comment and invitation:

> "An algebraic solution is presented because it is the only method apparent to the editor by which the necessary results can be obtained. If any reader can submit a simple arithmetical solution, producing correct results, it will be welcomed and published, for the editor cannot believe that the examiners expected an algebraic solution involving three unknowns. So much mathematical ability has never been expected of candidates in the past, and the editor feels, therefore, that he must have overlooked some simpler method."

This invitation was accepted by about a dozen readers. It is impossible to publish all the solutions received, and the following are therefore selected:

Solutions by E. B. Escott, Oak Park, Illinois

"In the first solution I start with approximate values, namely the value of the outside assets. Then I add the corrections—15 per cent. of B and 15 per cent. of C, the correction for A, which gives the second approximation to A. In the same way, form the second approximations to B and to C.

"Then start the problem over, using these new approximations in the same way that the first approximations were used, giving the third approximations as shown. When the approximations no longer change, I know that I have the correct result.

"One advantage of this method is that since each new approximation is obtained by starting the work over, errors—except in the last computation —are automatically eliminated.

"In the second method, after obtaining the second approximations, instead of recommencing the work, I merely add 15 per cent. of the *correction* to B and 15 per cent. of the *correction* to C for the correction to the second approximation to A. By this method, the rapid decrease in the size of the corrections is evident, showing that the work will soon converge to the correct result. This method does not have the advantage of the automatic elimination of errors which the first method has.

"In the third solution, by using suitably chosen multipliers—found by the method of 'cross-multiplication,' two unknowns are eliminated at the same time, which saves time and also conduces to greater accuracy, since it is not necessary to substitute the value of an unknown quantity just found, which may not be accurate."

FIRST SOLUTION

A		B		C	
1st approx. to A	$ 850,000.00	1st approx. to B	$ 925,000.00	1st approx. to C	$2,290,000.00
.15 B	138,750.00	.15 A	199,837.50	.05 A	66,612.50
.15 C	343,500.00	.10 C	229,000.00	.05 B	67,691.88
2nd approx. to A	1,332,250.00	2nd approx. to B	1,353,837.50	2nd approx. to C	2,424,304.38
	850,000.00		925,000.00		2,290,000.00
.15 B	203,075.63	.15 A	212,508.20	.05 A	70,836.07
.15 C	363,645.66	.10 C	242,430.44	.05 B	68,996.93
3rd approx. to A	1,416,721.29	3rd approx. to B	1,379,938.64	3rd approx. to C	2,429,833.00
	850,000.00		925,000.00		2,290,000.00
.15 B	206,990.80	.15 A	213,219.87	.05 A	71,073.29
.15 C	364,474.95	.10 C	242,983.30	.05 B	69,060.16
4th approx. to A	1,421,465.75	4th approx. to B	1,381,203.17	4th approx. to C	2,430,133.45
	850,000.00		925,000.00		2,290,000.00
.15 B	207,180.48	.15 A	213,255.08	.05 A	71,085.03
.15 C	364,520.02	.10 C	243,013.35	.05 B	69,063.42
5th approx. to A	1,421,700.50	5th approx. to B	1,381,268.43	5th approx. to C	2,430,148.45
	850,000.00		925,000.00		2,290,000.00
.15 B	207,190.26	.15 A	213,256.88	.05 A	71,085.63
.15 C	364,522.27	.10 C	243,014.85	.05 B	69,063.59
6th approx. to A	1,421,712.53	6th approx. to B	1,381,271.73	6th approx. to C	2,430,149.22
	850,000.00		925,000.00		2,290,000.00
.15 B	207,190.75	.15 A	213,256.97	.05 A	71,085.66
.15 C	364,522.38	.10 C	243,014.92	.05 B	69,063.60
7th approx. to A	1,421,713.13	7th approx. to B	1,381,271.89	7th approx. to C	2,430,149.26
	850,000.00		925,000.00		2,290,000.00
.15 B	207,190.78	.15 A	213,256.98	.05 A	71,085.66
.15 C	364,522.39	.10 C	243,014.93	.05 B	69,063.60
8th approx. to A	1,421,713.17	8th approx. to B	1,381,271.91	8th approx. to C	2,430,149.26

SECOND SOLUTION

A			B			C		
1st approximation		$ 850,000.00			$925,000.00			$2,290,000.00
Corr. 15% of B	$ 138,750.00		15% of A	$ 199,837.50		5% of A	$ 66,612.50	
Corr. 15% of C	343,500.00		10% of C	229,000.00		5% of B	67,691.88	
Total correction		482,250.00	Total correction		428,837.50	Total correction		134,304.38
2nd approximation		1,332,250.00			1,353,837.50			2,424,304.38
15% of corr. to B	64,325.63		15% of corr. to A	12,670.69		5% of corr. to A	4,223.56	
15% of corr. to C	20,145.66		10% of corr. to C	13,430.44		5% of corr. to B	1,305.06	
Total correction		84,471.29	Total correction		26,101.13	Total correction		5,528.62
3rd approximation		1,416,721.29			1,379,938.63			2,429,833.00
15% of corr. to B	3,915.17		15% of corr. to A	711.67		5% of corr. to A	237.22	
15% of corr. to C	829.29		10% of corr. to C	552.86		5% of corr. to B	63.23	
Total correction		4,744.46			1,264.53			300.45
4th approximation		1,421,465.75			1,381,203.16			2,430,133.45
15% of corr. to B	189.68		15% of corr. to A	35.21		5% of corr. to A	11.74	
15% of corr. to C	45.07		10% of corr. to C	30.05		5% of corr. to B	3.26	
Total correction		234.75			65.26			15.00
5th approximation		1,421,700.50			1,381,268.42			2,430,148.45
15% of corr. to B	9.79		15% of corr. to A	1.81		5% of corr. to A	.60	
15% of corr. to C	2.25		10% of corr. to C	1.50		5% of corr. to B	.17	
Total correction		12.04			3.31			.77
6th approximation		1,421,712.54			1,381,271.73			2,430,149.22
15% of corr. to B	.50		15% of corr. to A	.09		5% of corr. to A	.03	
15% of corr. to C	.12		10% of corr. to C	.08		5% of corr. to B	.01	
Total correction		.62			.17			.04
7th approximation		1,421,713.16			1,381,271.90			2,430,149.26
15% of corr. to B	.03		15% of corr. to A	.01		5% of corr. to A	.00	
15% of corr. to C	.01		10% of corr. to C	.00		5% of corr. to B	.00	
Total correction		.04			.01			.00
8th approximation		1,421,713.20			1,381,271.91			2,430,149.26

THIRD SOLUTION—BY ALGEBRA

$$\begin{aligned} A - .15\,B - .15\,C &= \$850{,}000 && (1)\\ -.15\,A + B - .10\,C &= 925{,}000 && (2)\\ -.05\,A - .05\,B + C &= 2{,}290{,}000 && (3) \end{aligned}$$

Multiply each equation by 20 to clear of fractions

$$\begin{aligned} 20\,A - 3\,B - 3\,C &= 17{,}000{,}000 && (4)\\ -3\,A + 20\,B - 2\,C &= 18{,}500{,}000 && (5)\\ -A - B + 20\,C &= 45{,}800{,}000 && (6) \end{aligned}$$

Multiply (4) by 398
(5) by 63
(6) by 66
and add. (These multipliers are obtained by 'cross multiplication.')

We have

$$\begin{aligned} 7{,}705\,A &= 10{,}954{,}300{,}000\\ A &= 1{,}421{,}713.1732 \end{aligned}$$

Multiply (4) by 62
(5) by 397
(6) by 49
and add.

We have

$$\begin{aligned} 7{,}705\,B &= 10{,}642{,}700{,}000\\ B &= 1{,}381{,}271.9014 \end{aligned}$$

Multiply (4) by 1
(5) by 1
(6) by 17
and add.

We have

$$\begin{aligned} 335\,C &= 814{,}100{,}000\\ C &= 2{,}430{,}149.2537 \end{aligned}$$

Solution by H. E. Bowman, Tacoma, Washington

	A Owning 15%B : 15%C		B Owning 15%A : 10%C		C Owning 5%A : 5%B	
Capital stock	$1,000,000.00		$ 750,000.00		$2,000,000.00	
Surplus	250,000.00		500,000.00		400,000.00	
	1,250,000.00		1,250,000.00		2,400,000.00	
Add to bring investment in B to par..	12,500.00		Add to bring investment in C to par.. 25,000.00		Deduct to bring investment in B to par 22,500.00	
	1,262,500.00		1,275,000.00		2,377,500.00	
Add 15% B's surplus of....	$525,000.00	78,750.00	Add 15% A's adj. surp. of.. 397,875.00	59,681.25	Add 5% A's adj. surplus of..	$397,875.00 { 19,893.75
Add 15% C's surplus of....	377,500.00	56,625.00	Add 10% C's surplus of 377,500.00	37,750.00	Add 5% B's adj. surplus of..	622,431.25 { 31,121.56
Add 15% B'c add'l surplus of	97,431.25	{ 14,614.69	Add 15% A's add'l surplus of	22,266.99 { 3,340.05	Add 5% A's add'l surplus of	22,266.99 { 1,113.35
Add 15% C's " " "	51,015.31	{ 7,652.30	Add 10% C's " " "	51,015.31 { 5,101.53	Add 5% B's " " "	8,441.58 { 422.08
Add 15%'B's " " "	8,441.58	{ 1,266.24	Add 15% A's " " "	1,496.55 { 224.48	Add 5% A's " " "	1,496.55 { 74.83
Add 15% C's " " "	1,535.43	{ 230.31	Add 10% C's " " "	1,535.43 { 153.54	Add 5% B's " " "	378.02 { 18.90
Add 15% B's " " "	378.02	{ 56.70	Add 15% A's " " "	70.76 { 10.61	Add 5% A's " " "	70.76 { 3.54
Add 15% C's " " "	93.73	{ 14.06	Add 10% C's " " "	93.73 { 9.37	Add 5% B's " " "	19.98 { 1.00
Add 15% B's " " "	19.98	{ 3.00	Add 15% A's " " "	3.68 { .55	Add 5% A's " " "	3.68 { .18
Add 15% C's " " "	4.54	{ .68	Add 10% C's " " "	4.54 { .45	Add 5% B's " " "	1.00 { .05
Add 15% B's " " "	1.00	{ .15	Add 15% A's " " "	.18 { .03	Add 5% A's " " "	.18 .01
Add 15% C's " " "	.23	{ .03	Add 10% C's " " "	.23 { .02		
Add 15% B's " " "	.05	.01			Add 5% B's " " "	.05
Add 15% C's " " "	.01					
Total net worths	$1,421,713.17		$1,381,271.88		$2,430,149.25	

The figures are paired merely to give a little clearer view of the process.

Solution by E. S. Thomas, Cincinnati, Ohio

A	B	C
$1,250,000.00	$1,250,000.00	$2,400,000.00
87,500.00	37,500.00	12,500.00
60,000.00	65,000.00	2,500.00
1,397,500.00	1,352,500.00	2,415,000.00
15,375.00	22,125.00	7,375.00
2,250.00	1,500.00	5,125.00
1,415,125.00	1,376,125.00	2,427,500.00
3,543.75	2,643.75	881.25
1,875.00	1,250.00	1,181.25
1,420,543.75	1,380,018.75	2,429,562.50
584.06	812.81	270.94
309.38	206.25	194.69
1,421,437.19	1,381,037.81	2,430,028.13
152.86	134.02	44.67
69.84	46.56	50.95
1,421,659.89	1,381,218.39	2,430,123.75
27.09	33.40	11.14
14.34	9.56	9.03
1,421,701.32	1,381,261.35	2,430,143.92
6.44	6.21	2.08
3.03	2.02	2.15
1,421,710.79	1,381,269.58	2,430,148.15
1.23	1.42	.48
.63	.42	.41
1,421,712.65	1,381,271.42	2,430,149.04
.29	.28	.09
.13	.09	.09
1,421,713.07	1,381,271.79	2,430,149.22
.06	.06	.02
.03	.02	.02
1,421,713.16	1,381,271.87	2,430,149.26

Note: The first additions are the differences between cost of stocks and net worths as shown by the respective books. And thereafter the additions to

A equal 15% of previous additions to B and C
B equal 15% of previous additions to A and 10% C
C equal 5% of previous additions to A and B
By previous addition is meant the addition immediately preceding.

A	B	C
$1,250,000.00	$1,250,000.00	$2,400,000.00
147,500.00	102,500.00	15,000.00
17,625.00	23,625.00	12,500.00
5,418.75	3,893.75	2,062.50
893.44	1,019.06	465.63
222.70	180.58	95.62
41.43	42.96	20.17
9.47	8.23	4.23
1.86	1.84	.89
.42	.37	.18
.09	.08	.04
1,421,713.16	1,381,271.87	2,430,149.26

Note: This is a practical way, which saves work. See preceding computation for explanation of method.

The sum of the first additions to B and to C equals 117,500, and 15% of this equals 17,625, which is the next addition to A. The sum of A and B equals 250,000, and 5% of this equals 12,500, which is the next addition to C.

Solution by John W. Sparling, Seattle, Washington

	A	B	C
Assets	$1,100,000.00	$1,675.00	$3,390.00
Liabilities	250,000.00	750.00	1,100.00
Net worth	$ 850,000.00	$ 925.00	$2,290.00

80% to stockholders	80% to stockholders	75% to stockholders
15 to B	15 to A	15 to A
5 to C	5 to C	10 to B
100	100	100
$ 680,000.00 to stock	$ 740,000.00 to stock	$1,717,500.00 to stock
127,500.00 to B	138,750.00 to A	343,500.00 to A
42,500.00 to C	46,250.00 to C	229,000.00 to B
$ 850,000.00	$ 925,000.00	$2,290,000.00
$ 138,750.00	$ 127,500.00	$ 46,250.00
343,500.00	229,000.00	42,500.00
$ 482,250.00	$ 356,500.00	$ 88,750.00
$ 385,800.00 to stock	$ 285,200.00 to stock	$ 66,562.50 to stock
72,337.50 to B	53,475.00 to A	(1) 13,312.50 to A
24,112.50 to C	17,825.00 to C	(1)& 8,875.00 to B
$ 482,250.00	$ 356,500.00	$ 88,750.00

Following the same procedure until the full balance is gone, then adding the stockholders together with final result:

A	$1,137,370.54	—	27.979 plus
B	1,105,017.52	—	27.183 plus
C	1,822,611.94	—	44.836 plus

Solution by W. T. Sunley, Chicago

FIRST SOLUTION

"The balance-sheets may be rearranged to show the interest which each company has in the other as carried on their present balance-sheets, thus:

	A	B	C
Assets other than stock	$1,100,000	$1,675,000	$3,390,000
Stock of A	.....	150,000	50,000
Stock of B	100,000	.....	60,000
Stock of C	300,000	175,000	.....
Total assets	$1,500,000	$2,000,000	$3,500,000
Liabilities	250,000	750,000	1,100,000
Net worth	$1,250,000	$1,250,000	$2,400,000

"This statement may now be rearranged to show the net worth of each corporation, exclusive of interest in other companies.

	A	B	C
Net worth exclusive of stock in other companies	$ 850,000	$ 925,000	$2,290,000
Stock of A	.....	150,000	50,000
Stock of B	100,000	.....	60,000
Stock of C	300,000	175,000	.....
Total net worth	$1,250,000	$1,250,000	$2,400,000

"The next step would be to change the valuation of the stock of A held by B, from $150,000 to 15% of the net worth of A. But since the net worth of A is dependent upon the value of the stock which A holds in B (changing $100,000 valuation to 15% of B's net worth), we cannot value 'stock of A' held by B at 15% of $1,250,000.

"The valuation which should be placed on the intercompany stock holdings can be determined by trial or algebraic equations.

"The 'trial' method consists of substituting the percentages of the respective net worths as the valuations of the intercompany holdings until net-worth figures are obtained which actually fulfill the percentage requirements.

"The following tabulation shows the 'trial' method. Starting with the figures as given in the problem the first trial is made by substituting 15% of B's net worth as originally given for A's stock in company B. This changes the valuation from $100,000 to $187,500. In a like manner, A's stock in company C is changed to 15% of $2,400,000, which is $360,000; and similarly all the intercompany stock is revalued on this basis.

"As a result the first trial shows *new* net worth figures. So it is necessary to recalculate the valuation of 'stock of B' held by A; so in the second trial we substitute 15% of B's net worth, as shown by the first trial in place of $187,500. This new figure is $202,875.

"In a similar manner, the second trial figures for the valuations of the other intercompany stock holdings are calculated using as a basis the net-worth figures developed in the first trial.

"Then adding these new valuations to the respective 'net worths exclusive of the stock in other companies,' gives *new* net-worth figures. So a third trial is made, substituting stock valuations based on the net worths as developed in the second trial.

"This process is continued until there is no material difference between the valuation determined by the test. This occurs in the twelfth trial."

C A	As given in problems	Trial 1	Trial 2	Trial 3
Net worth exclusive of stock in other companies	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00
Stock of B (15%)..	100,000.00	187,500.00	202,875.00	206,418.75
Stock of C (15%)..	300,000.00	360,000.00	362,250.00	364,125.00
Total	$1,250,000.00	$1,397,500.00	$1,415,125.00	$1,420,543.75
B				
Net worth exclusive of stock in other companies	925,000.00	925,000.00	925,000.00	925,000.00
Stock of A (15%)..	150,000.00	187,500.00	209,625.00	212,268.75
Stock of C (10%)..	175,000.00	240,000.00	241,500.00	242,750.00
Total	$1,250,000.00	$1,352,500.00	$1,376,125.00	$1,380,018.75

C	As given in problems	Trial 1	Trial 2	Trial 3
Net worth exclusive of stock in other companies	2,290,000.00	2,290,000.00	2,290,000.00	2,290,000.00
Stock of A (5%)...	50,000.00	62,500.00	69,875.00	70,756.25
Stock of B (5%)...	60,000.00	62,500.00	67,625.00	68,806.25
Total	$2,400,000.00	$2,415,000.00	$2,427,500.00	$2,429,562.50

A	Trial 4	Trial 5	Trial 6	Trial 7
Net worth exclusive of stock in other companies	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00
Stock of B (15%)..	207,002.82	207,155.67	207,182.76	207,189.20
Stock of C (15%)..	364,434.38	364,504.22	364,518.56	364,521.59
Total	$1,421,437.20	$1,421,659.89	$1,421,701.32	$1,421,710.79
B				
Net worth exclusive of stock in other companies	$ 925,000.00	$ 925,000.00	$ 925,000.00	$ 925,000.00
Stock of A (15%)..	213,081.56	213,215.58	213,248.98	213,255.20
Stock of C (10%)..	242,956.25	243,002.82	243,012.38	243,014.39
Total	$1,381,037.81	$1,381,218.40	$1,381,261.36	$1,381,269.59
C				
Net worth exclusive of stock in other companies	$2,290,000.00	$2,290,000.00	$2,290,000.00	$2,290,000.00
Stock of A (5%)...	71,027.19	71,071.86	71,082.99	71,085.07
Stock of B (5%)...	69,000.94	69,051.89	69,060.92	69,063.07
Total	$2,430,028.13	$2,430,123.75	$2,430,143.91	$2,430,148.14

A	Trial 8	Trial 9	Trial 10	Trial 11
Net worth exclusive of stock in other companies	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00
Stock of B (15%)..	207,190.44	207,190.71	207,190.77	207,190.78
Stock of C (15%)..	364,522.22	364,522.35	364,522.38	364,522.39
Total	$1,421,712.66	$1,421,713.06	$1,421,713.15	$1,421,713.17
B				
Net worth exclusive of stock in other companies	$ 925,000.00	$ 925,000.00	$ 925,000.00	$ 925,000.00
Stock of A (15%)..	213,256.62	213,256.90	213,256.96	213,256.97
Stock of C (10%)..	243,014.81	243,014.90	243,014.92	243,014.92
Total	$1,381,271.43	$1,381,271.80	$1,381,271.88	$1,381,271.89
C				
Net worth exclusive of stock in other companies	$2,290,000.00	$2,290,000.00	$2,290,000.00	$2,290,000.00
Stock of A (5%)...	71,085.54	71,085.63	71,085.65	71,085.66
Stock of B (5%)...	69,063.48	69,063.57	69,063.59	69,063.59
Total	$2,430,149.02	$2,430,149.20	$2,430,149.24	$2,430,149.25

	Trial 12
A	
Net worth exclusive of stock in other companies	$ 850,000.00
Stock of B (15%)	207,190.78
Stock of C (15%)	364,522.39
Total	$1,421,713.17
B	
Net worth exclusive of stock in other companies	$ 925,000.00
Stock of A (15%)	213,256.98
Stock of C (10%)	243,014.92
Total	$1,381,271.90
C	
Net worth exclusive of stock in other companies	$2,290,000.00
Stock of A (5%)	71,085.66
Stock of B (5%)	69,063.59
Total	$2,430,149.25

"By this test method we have obtained the following net-worth valuations for the three companies:

Corporation A	$1,421,713.17
Corporation B	1,381,271.90
Corporation C	2,430,149.25
Total	$5,233,134.22

"The last column of the 'trial' tabulation gives the balance-sheets as revised to show the corrected valuation of the intercompany stock.

"The next step is to calculate the number of shares each corporation will receive from D upon turning in its net worth and receiving its pro rata number of shares. This is done by adding the net worths and calculating the percentage which each net worth is of the combined net worth."

	Total paid to D	Per cent. of total	Pro rata number of shares
Corporation A	$1,421,713.17	27.16752%	271,675.2
Corporation B	1,381,271.90	26.39473%	263,947.3
Corporation C	2,430,149.25	46.43775%	464,377.5
Total	$5,233,134.22	100.00000%	1,000,000.0

"D now holds stock in A, B and C; and when A, B and C distribute 'D company stock' to their stockholders, D will receive 'D company stock' for its holdings in A, B and C."

	D receives back
A—receives 271,675.2 shares in D. A then pays back to D in liquidation of A company's stock held by D, 20% of 271,675.2	= 54,335.04
B—pays D 20% of 263,947.3	= 52,789.46
C—pays D 25% of 464,377.5	= 116,094.4
Total	223,218.9

Then

D stock outstanding:

Held by A company stockholders, 80% of 271,675.2	217,340.16
By B company stockholders, 80% of 263,947.3	211,157.84
By C company stockholders, 75% of 464,377.5	348,283.1
Total outstanding	776,781.1

Percentages of outstanding:

A company	27.9796%
B company	27.1837%
C company	44.8367%
	100.0000%

"D company then proceeds to distribute to its stockholders the D company stock which it received from A, B and C, as follows:

Those who were stockholders in company A, 27.9796% of 223,218.9 shares	62,455.84
Those who were stockholders in company B, 27.1837% of 223,218.9 shares	60,679.16
Those who were stockholders in company C, 44.8367% of 223,218.9 shares	100,083.9
Total distributed by D	223,218.9

"The total D company stock will then be held as follows:

Those who were stockholders in company A:		
Received from corporation A	217,340.16	
Received from corporation D	62,455.84	279,796
Those who were stockholders in company B:		
Received from corporation B	211,157.84	
Received from corporation D	60,679.16	271,837
Those who were stockholders in company C:		
Received from corporation C	348,283.1	
Received from corporation D	100,083.9	448,367
Total shares of D		1,000,000

"The problem calls for the percentage of shares received by the stockholders in A, B and C. Therefore:

Stockholders of A	27.9796%
Stockholders of B	27.1837%
Stockholders of C	44.8367%
	100.0000%

The total equity or paid-in value of the consolidated capital will be the combined net worths *exclusive* of the intercompany stock holdings that have now been liquidated, the stock surrendered and canceled, as follows:

From corporation A	$ 850,000
From corporation B	925,000
From corporation C	2,290,000
Consolidated capital	$4,065,000

SECOND SOLUTION

"The balance-sheets may be rearranged to show the interest which each company has in the other as carried on their present balance-sheets, thus:

	A	B	C
Assets other than stock	$1,100,000	$1,675,000	$3,390,000
Stock of A	.....	150,000	50,000
Stock of B	100,000	.....	60,000
Stock of C	300,000	175,000	.....
Total assets	$1,500,000	$2,000,000	$3,500,000
Liabilities	250,000	750,000	1,100,000
Net worth	$1,250,000	$1,250,000	$2,400,000

"This statement may now be rearranged to show the net worth of each corporation, exclusive of interest in other companies.

	A	B	C
Net worth exclusive of stock in other companies	$ 850,000	$ 925,000	$2,290,000
Stock of A	.....	150,000	50,000
Stock of B	100,000	.....	60,000
Stock of C	300,000	175,000	.....
Total net worth	$1,250,000	$1,250,000	$2,400,000

"In this solution it is assumed that A, B and C turn over to D their respective net worths *exclusive* of stock in other companies.

"Then corporations A, B and C will receive from D their proportionate number of shares of D company stock as follows:

A pays in	$ 850,000
B pays in	925,000
C pays in	2,290,000
Combined capital	$4,065,000
A's share is	20.910209%
B's share is	22.755228%
C's share is	56.334563%
Total	100.000000%

Therefore:

Corporation A receives 209,102.09 shares of D company stock.
Corporation B receives 227,552.28 shares of D company stock.
Corporation C receives 563,345.63 shares of D company stock.

Total..... 1,000,000.00

"When corporation A receives 209,102.09 shares of D company stock, it distributes them to its stockholders—80% of the 209,102.09 is paid to individuals, 15% to corporation B and 5% to corporation C.

"Now B had received 227,552.28 from D and in addition will receive 15% of 209,102.09 from A, and when it distributes all this stock corporation A will receive more shares of D from B, which it will then redistribute to its stockholders among whom is B. And B upon receiving these shares will distribute to its stockholders, among whom is A, so A will receive a third lot of shares which it will redistribute, some going back to B again.

"This distribution may be made in accordance with the following tabulation:

	Corporation A	Corporation B	Corporation C	Individual stockholders A	Individual stockholders B	Individual stockholders C
1. Corp. A receives from D	209,102.09	.....	.....	.....	.....	.....
80% to individuals A	.....	.....	.....	167,281.672	.....	.....
15% to corp. B	.....	31,365.3135	.....	.....	.....	.....
5% to corp C	.....	.....	10,455.1045	.....	.....	.....
2. Corp. B receives from D....	.....	227,552.28	.....	.....	.....	.....
Total (from A and D)	.....	258,917.5936	.....	.....	.....	.....
80% to individuals B	.....	.....	.....	.....	207,134.0748	.....
15% to corp. A	38,837.6390	.....	.....	.....	.....	.....
5% to corp C	.....	.....	12,945.8796	.....	.....	.....
3. Corp. C receives from D....	.....	.....	563,345.63	.....	.....	.....
Total (from A & B & D) ...	.....	.....	586,746.6141	.....	.....	.....
75% to individuals C	.....	.....	.....	.....	.....	440,059.9606
15% to corp. A	88,011.9921	.....	.....	.....	.....	.....
10% to corp B	.....	58,674.6614	.....	.....	.....	.....
4. Corp. A (from B & C)	126,849.6311	.....	.....	.....	.....	.....
80% to individuals A	.....	.....	.....	101,479.7049	.....	.....
15% to corp. B	.....	19,027.4447	.....	.....	.....	.....
5% to corp. C	.....	.....	6,342.4815	.....	.....	.....

	Corporation A	Corporation B	Corporation C	Individual stockholders A	Individual stockholders B	Individual stockholders C
5. Corp. B (from A & C)		77,702.1061				
80% to individuals B					62,161.6849	
15% to corp. A	11,655.3159					
5% to corp. C			3,855.1053			
6. Corp. C (from A & B)			10,227.5868			
75% to individuals C						7,670.6901
15% to corp A	1,534.1380					
10% to corp B		1,022.7587				
7. Corp. A (from B & C)	13,189.4539					
80% to individuals A				10,551.5631		
15% to corp. B		1,978.4181				
5% to corp. C			659.4727			
8. Corp. B (from A & C)		3,001.1768				
80% to individuals B					2,400.9414	
15% to corp. A	450.1765					
5% to corp. C			150.0589			
9. Corp. C (from A & B)			809.5316			
75% to individuals C						607.1487
15% to corp. A	121.4297					
10% to corp. B		80.9532				

	Corporation A	Corporation B	Corporation C	Individual stockholders A	Individual stockholders B	Individual stockholders C
10. Corp. A (from B & C)	571.6062					
80% to individuals A				457.285		
15% to corp. B		85.7409				
5% to corp. C			28.5803			
11. Corp. B (from A & C)		166.6941				
80% to individuals B					133.3553	
15% to corp A	25.0041					
5% to corp C			8.3347			
12. Corp. C (from A & B)			36.9150			
75% to individuals C						27.6862
15% to corp. A	5.5372					
10% to corp. B		3.6916				
13. Corp. A (from B & C)	30.5413					
80% to individuals A				24.433		
15% to corp. B		4.5812				
5% to corp. C			1.5271			
14. Corp. B (from A & C)		8.2728				
80% to individuals B					6.6183	
15% to corp. A	1.2409					
5% to corp. C			.4136			

	Corporation A	Corporation B	Corporation C	Individual stockholders A	Individual stockholders B	Individual stockholders C
15. Corp. C (from A & B)			1.9407			
75% to individuals C						1.4555
15% to corp. A	.2911					
10% to corp. B		.1921				
16. Corp. A (from B & C)	1.532					
80% to individuals A				1.2256		
15% to corp. B		.2298				
5% to corp. C			.0766			
17. Corp. B (from A & C)		.4239				
80% to individuals B					.3391	
15% to corp. A	.0636					
5% to corp. C			.0212			
18. Corp. C (from A & B)			.0978			
75% to individuals C						.0733
15% to corp. A	.0147					
10% to corp. B		.0098				
Total	.0783	.0098		279,795.8836	271,837.0138	448,367.0144

Solution by G. Travis, San Francisco

	First approx.	Second approx.	Third approx.	Fourth approx.	Fifth approx.	Sixth approx.	Seventh approx.	Eighth approx.
Company "A"								
Net assets	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00	$ 850,000.00
Add 15% "B"	138,750.00[1]	203,075.63[7]	206,990.79	207,180.47	207,190.26	207,190.76	207,190.79	207,190.79
Add 15% "C"	343,500.00[2]	363,645.66[8]	364,474.95	364,520.02	364,522.27	364,522.38	364,522.39	364,522.39
Total net assets Co. "A"	$1,332,250.00	$1,416,721.29	$1,421,465.74	$1,421,700.49	$1,421,712.53	$1,421,713.14	$1,421,713.18	$1,421,713.18
Company "B"								
Net assets	$ 925,000.00	$ 925,000.00	$ 925,000.00	$ 925,000.00	$ 925,000.00	$ 925,000.00	$ 925,000.00	$ 925,000.00
Add 15% "A"	199,837.50[3]	212,508.19[9]	213,219.86	213,255.07	213,256.88	213,256.97	213,256.98	213,256.98
Add 10% "C"	229,000.00[4]	242,430.44[10]	242,983.30	243,013.35	243,014.85	243,014.92	243,014.93	243,014.93
Total net assets Co. "B"	$1,353,837.50	$1,379,938.63	$1,381,203.16	$1,381,268.42	$1,381,271.73	$1,381,271.89	$1,381,271.91	$1,381,271.91
Company "C"								
Net assets	$2,290,000.00	$2,290,000.00	$2,290,000.00	$2,290,000.00	$2,290,000.00	$2,290,000.00	$2,290,000.00	$2,290,000.00
Add 5% "A"	66,612.50[5]	70,836.06[11]	71,073.29	71,085.02	71,085.63	71,085.66	71,085.66	71,085.66
Add 5% "B"	67,691.88[6]	68,996.93[12]	69,060.16	69,063.43	69,063.58	69,063.59	69,063.60	69,063.60
Total net assets Co. "C"	$2,424,304.38	$2,429,832.99	$2,430,133.45	$2,430,148.45	$2,430,149.21	$2,430,149.25	$2,430,149.26	$2,430,149.26

[1] 15% of $ 925,000.00 equals $ 138,750.00
[2] 15% of 2,290,000.00 " 343,500.00
[3] 15% of 1,332,250.00 " 199,837.50
[4] 10% of 2,290,000.00 " 229,000.00
[5] 5% of 1,332,250.00 " 66,612.50
[6] 5% of 1,353,837.50 " 67,691.88
[7] 15% of 1,353,837.50 " 203,075.63
[8] 15% of $2,424,304.38 equals $ 363,645.66
[9] 15% of 1,416,721.29 " 212,508.19
[10] 10% of 2,424,304.38 " 242,430.44
[11] 5% of 1,416,721.29 " 70,836.06
[12] 5% of 1,379,938.63 " 68,996.93
and so on.

The allocation of the 1,000,000 shares of no-par-value stock is then determined in the following manner:

Company "A"				
Total net assets as revised		$1,421,713.18		
Less:				
15% held by Co. "B"	$ 213,256.98			
5% held by Co. "C"	71,085.66	284,342.64	$1,137,370.54	27.979%
Company "B"				
Total net assets as revised		$1,381,271.91		
Less:				
15% held by Co. "A"	$ 207,190.79			
5% held by Co. "C"	69,063.60	276,254.39	$1,105,017.52	27.183%
Company "C"				
Total net assets as revised		$2,430,149.26		
Less:				
15% held by Co. "A"	$ 364,522.39			
10% held by Co. "B"	243,014.93	607,537.32	$1,822,611.94	44.836%
Total consolidated net assets			$4,065,000.00	100%

The no-par-value stock of the new company is then apportioned in the following ratios:

Company "A"	27.979%
Company "B"	27.183%
Company "C"	44.836%

Correcting an Error of Omission

Editor, Students' Department:

Sir: I have studied the answers to accounting theory and practice, part II, of the American Institute examinations, May 17, 1923, as presented by you in the August number of The Journal of Accountancy, and wish to call your attention to an omission in the answer to question No. 3. This question reads as follows:

> "A corporation spends $500,000 on an advertising campaign during the first six months of the year 1922, and expects to begin to secure benefits therefrom on and after July 1, 1922, and for three succeeding years. How would you handle this expenditure on the published balance-sheet and profit-and-loss account issued to stockholders? How would you handle it on the income-tax return for 1922?"

Two specific questions are asked and you have submitted a full and explicit answer to the first question, which I believe is in accordance with good accounting practice, but you have failed to answer the second half of this question.

The answer to the second half of this question is that the charges must be deducted in the calendar year 1922. Office decision 1039, published on page 130 of cumulative bulletin No. 5, reads as follows:

> "A corporation conducted in its taxable year a national campaign of advertising its manufactured product. Inquiry is made as to whether

this expense of advertising must be charged off as an operating expense during the year in which it was incurred, or whether it can be carried as a deferred asset and charged off over a period of years.

"It is held that the expenses of such advertising campaign are deductible as a business expense only in the return for the year in which such expenses were paid or in the year in which liability therefor accrued, if the books of the company are kept on an accrual basis."

WM. W. JOHNSTON.

Springfield, Massachusetts.

Robert G. Severance and Edgar G. Lucker announce the opening of an office under the firm name of Lucker & Severance, with offices at 1051 Ellicott Square, Buffalo, New York.

Marwick, Mitchell & Co. announce that John Watt has been admitted to partnership in the firm and will continue at the Pittsburgh office of the firm as resident partner.

Price, Waterhouse & Co. announce the removal of their Los Angeles offices to the A. G. Bartlett building, 215 West Seventh street.

F. A. Morrison & Co. announce the opening of an office at 237 Tube Concourse building Jersey City, New Jersey.

J. H. Wren & Co., Norfolk, Virginia, announce that Stewart A. Steen has become a member of the firm.

Kinard & Olcott announce the removal of their El Dorado, Arkansas, offices to 16 Marks building.

Goldenberg, Rosenthal & Co. announce the removal of their offices to Widener building, Philadelphia.

Charles Gale announces the removal of his office to 294 Washington street, Boston, Massachusetts.

W. S. Dent announces the opening of offices in the Foster building, Denver, Colorado.

Samuel C. Hyer announces the removal of his office to 150 Nassau street, New York.

Elias A. Penzell announces the opening of an office at 276 Fifth avenue, New York.

Correspondence

Intercompany Profits in Consolidated Statements

Editor, The Journal of Accountancy:

SIR: Not wishing to engage in a controversy through your columns, but feeling that the subject of consolidated statements is one of growing importance to the accounting profession, I am making bold to give you my comments upon the letter from W. T. Sunley published on page 310 of the October, 1923, issue of THE JOURNAL OF ACCOUNTANCY, which discusses an article contributed by me entitled *Elimination of Intercompany Profits in Consolidated Statements,* published in the July JOURNAL.

The question at issue regards profits or losses upon sales made by one affiliated company to another, in cases where there are minority stock interests concerned. Under the generally accepted principle, no account is taken of such transactions until the subject-matter of the sale has been acquired by an outside purchaser. Mr. Sunley, in an article published in the May JOURNAL, contended, and to my mind proved, that in instances where goods were sold at a profit by a subsidiary having minority stockholders to a parent company, the proportion of the profit made by the subsidiary which must be allowed for in the consolidated surplus as applicable to the minority should be considered as a part of the cost of the consolidated inventory and should not be eliminated. In my article, I endeavored, as Mr. Sunley correctly states, to go a little further in applying the same principle whether the parent company be buyer or seller—in other words, viewing the latter instance as an "outside" sale with a profit or loss realized to the extent that minority holders are interested in the transactions.

Mr. Sunley seems to object to proceeding to this extent for two reasons: first, that it would open an avenue for manipulation, and, secondly, that it leans too much toward the legal viewpoint of considering the affiliated companies as separate and distinct corporations, rather than treating them from the accountant's point of view as one business consisting of related branches.

In regard to the former criticism, the avenue for manipulation appears to be opened as widely under the present rule or Mr. Sunley's suggestion as under mine. To reverse the illustration used by him, let us imagine that property worth $100,000 is sold not at a profit but at a loss by the parent to the subsidiary, say for $5,000. Under the present practice of eliminating this transaction altogether, because the contracting parties are affiliated, and under Mr. Sunley's plan of eliminating it, because the parent is the seller, the consolidated statement would not reflect any change at all by reason of it. Corporate officers may happen to be more interested in the profits of a subsidiary than of the parent and thus be pleased to have the matter exhibited in this manner. The same sort of manipulation might be practised by causing the parent to purchase goods from a subsidiary at a loss to the latter, in this way decreasing the proportion of consolidated surplus applicable to the minority interests.

If we wish to be consistently conservative, we should prohibit the taking up of losses on sales by a subsidiary to a parent or the taking up of profits on sales by a parent to a subsidiary, and should insist upon showing profits on sales by a subsidiary to a parent and losses on sales by a parent to a subsidiary. This, to my mind, is a logical requirement if we adopt as our guiding principle that the consolidated statement is to reflect only those intercompany transactions which are favorable to the minority holders and not those favorable to the parent or majority holders. However, there seems to be no good reason for attempting to curb manipulation through any rule of this kind—in the first place, because it would not be an effective deterrent, and then it necessitates an understatement of the book value of the majority holdings.

In regard to the second point made by Mr. Sunley—that the adoption of the principle suggested would, in cases where the parent company was the seller, result in losing sight of the accounting unity of the enterprise—I must confess that I fail to see why this is so any more than when the parent is buyer. The consistent recognition of minority interests in intercompany transactions is the most accurate viewpoint obtainable. It disregards the fact of separate corporate entities as far as the stock interests of the parent company are concerned, endeavoring to treat the equity of the parent in each subsidiary as part and parcel of the consolidated undertaking. It seeks to eliminate the equity of the minority in each and every bona-fide transaction.

Perhaps Mr. Sunley himself adopts a somewhat strict legal point of view in contending that an actual liquidation or judicial approval is necessary before a sale can be considered closed. However, he does not insist upon this position when the parent is buyer but only when it is seller.

I am fully in accord with the principle enunciated in the last paragraph of Mr. Sunley's letter—"that in actual practice, the accountant will, of course, guide his actions by the attendant circumstances." If a sale has been made by one affiliated company to another and the accountant has satisfied himself of the propriety of the transaction, which is his first duty, then his second duty is to state the results of that transaction in the most accurate manner possible. In my humble opinion, the accounting profession cannot go far wrong in approving mathematically exact statements if the "attendant circumstances" indicate no unfair manipulation, realizing that artificial rules intended to prevent dishonest practices can just as frequently be employed as a cloak for such acts.

Yours truly,
GORDON C. CARSON.

Savannah, Georgia, Oct. 8, 1923.

The firm of A. W. Wright & Co., consisting of A. W. Wright and Kurt W. Freund, announce the opening of an office at 303 Fifth avenue, New York, and also an office in Baltimore, Maryland.

Book Reviews

THE BUREAU OF INTERNAL REVENUE, ITS HISTORY AND ORGANIZATION, by LAWRENCE F. SCHMECKEBIER and FRANCIS X. A. EBLE. *The Johns Hopkins Press,* Baltimore.

Indignation brought about by one's transactions with the bureau of internal revenue seems to have eminent precedent. When the bureau's activities can cause an insurrection, as it did in the famous "whiskey rebellion" of 1794, it must not be expected that an ordinary citizen in 1923 can look with equanimity upon the depletion of his cash resources by this very busy bureau.

The monograph under review is crowded with the recital of many astonishing facts and figures, as well as solid information of invaluable character to every one who takes proper pride in his government and its instrumentalities. The satisfying thought arising in one's mind when reading it is that there can be no doubt of the authenticity of the facts which it sets forth.

When one realizes that the commissioner of internal revenue is charged with the duty of collecting about 78 per cent. of the government's ordinary receipts; that he is charged with enforcement of national prohibition and the regulation of traffic in narcotics as well as other extremely important duties, one wonders where can be found a man to assume such a staggering load of responsibility. However, wisdom, born of experience derived from a history dating back to the beginning of our government, has placed in the commissioner's hands a bureau of long standing, with many subdivisions and functioning fairly smoothly in carrying out the work with which it is charged. The monograph deals with this subject in an admirably comprehensive manner and is a credit to its authors, as well as to the Institute for Government Research which is responsible for its publication.

STEPHEN G. RUSK.

It is announced that the practices of Samuel Newberger and George W. Alexander have been merged. The practice will continue under the name of Samuel Newberger & Co., with offices at 38 Park Row, New York.

Morris Newmark and Elias Moss announce the formation of a partnership under the firm name of Newmark & Moss, with offices at 236 West 55th street, New York.

Isadore Amster announces the removal of his office to 1400 Broadway, New York.

Benjamin F. Garrett, A. Frank Harrison, Thomas D. Skinner and James E. Hammond announce formation of a partnership under the firm name of Garrett, Harrison, Skinner & Hammond, with offices in Orient building, 332 Pine street, San Francisco.

H. C. Crane & Company announce that Edward O. Harper has been admitted to partnership. The offices of the firm have been transferred to Shepherd building, Montgomery, Alabama.

Max Katz and William Lovey announce the formation of a partnership under the name of Katz & Lovey, with offices at 20 Broad street, New York.

William H. S. Jarvis & Co., Boston, announce that Frank J. McManus and Elwin MacLeod have been admitted to partnership in the firm.

Robinson, Kinney, Kling & Steen announce the opening of an office in the Anchor building, Roanoke, Virginia.

Wm. P. Kamps announces the removal of his offices to 30 North Dearborn street, Chicago, Illinois.

Herman A. Sarwin announces the removal of his office to 24 Branford place, Newark, New Jersey.

William Franzblau & Co. announce the removal of their offices to 233 West 42nd street, New York.

Cohn & Co. announce the removal of their offices to 24 Branford place, Newark, New Jersey.

Sudman Audit Co. announces the removal of its offices to 130 West 42nd street, New York.

Curtis Mechner announces the opening of an office at 200 Fifth avenue, New York.

Current Literature

Compiled in the Library of the American Institute of Accountants

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