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Corporations—Book Value

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The majority held that the absolute right of the petitioner to compel inspection ended with his removal from office. They granted him the opportunity to assert a possible qualified right of inspection at further proceedings, however, on the grounds of his potential liability for wrongful acts of the directors during his term of office. Judge Desmond, in a partial dissent, argued against the remission to Special Term on the grounds that petitioner, being neither a stockholder nor a director, has no rights at all to an inspection.

Book Value

The Court of Appeals entertained the problem of determining the correct book value of a corporation in *Aron v. Gillman*.[11] An agreement between the parties provided for a sale of shares of a jointly owned corporation by the first to die to the survivor "at the book value thereof." This was to be determined by the most recent audit of the books of the corporation, provided the audit be made not more than 60 days before the date of death. The items of dispute were an estimated inventory figure and a contingent reserve for taxes payable.

Judge Froessel, writing for the majority, held that the amount conceded by plaintiff to be the actual value of corporation's merchandise inventory on date of audit rather than the much smaller figure submitted to the accountant by the decedent president should be used to determine the book value of the stock. Also, the corporation's estimated income taxes for the period covered by the audit should have been deducted.

The courts of this state have never given an authoritative definition of the term "book value."[12] The principles have emerged, however, that book entries must be correct and complete and not made to defeat an outstanding claim, and that accepted accounting standards should be adhered to. It is regarded as good accounting practice for an auditor to take a physical sample of inventory figures supplied him, thus giving support to the majority result concerning the inventory.[13] It is likewise sound accounting practice that each dollar of income should bear its proportionate share of the costs of the enterprise, including the tax burden, as it is earned throughout the years.[14] Therefore, an interim audit made during the taxable year should include an estimate of the income taxes applicable to the period

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11. 309 N. Y. 157, 128 N. E. 2d 284 (1955).
12. See, 7 WHITE, NEW YORK CORPORATIONS, § 7.26.
13. American Institute of Accountants, report bulletin, September 19, 1939.
14. *Commissioner of Internal Revenue v. Shock, Gusmer & Co.*, 137 F. 2d 750, (3rd Cir. 1943); *Allen v. Atlanta Stove Works*, 138 F. 2d 452, (5th Cir. 1943).

in question. The mere fact that an item is not yet legally due and payable does not mean that it may be ignored as a liability.[15]

Judge Desmond, in a partial dissent, concurs as to the adjustment for taxes but disagrees with the revised valuation of the inventory. His position is based upon a strict interpretation of "book value" as the figures actually shown on the books. It would seem, however, that basic fairness to the parties as well as sound accounting procedure would require an adjustment to be made of the large discrepancy existing between the physical and the estimated inventory.

Liability of Parent For Subsidiary's Debts

In an action by a trustee in bankruptcy of an insolvent subsidiary corporation to compel the parent corporation to meet the obligations of its wholly-owned nonprofit subsidiary, judgment was given for defendant.[16]

Defendant is a corporation organized to obtain low cost housing for its stockholders. In order to erect houses on the property it owned, defendant organized a subsidiary corporation to do the contracting and construction work. The subsidiary was to sell at cost the houses it erected to the defendant, who would sell the completed house and lot to one of its stockholders. In 1949, two years after its creation, the subsidiary fell into a difficult financial position, and its creditors took over the management of the business under an extension agreement. Almost four years later the subsidiary was adjudicated a bankrupt. Subsequently the trustee in bankruptcy brought this action.

The exact situations which make a parent corporation liable for the debts of its wholly owned subsidiary seem never to have been specifically designated. Professor Ballantine has said, "Unfortunately it does not seem possible to lay down any definite test as to when the usual immunity of the stockholder should be disregarded."[17] Certainly the court will disregard the separate entity if there has been fraud or misrepresentation or an illegal purpose.[18] As to what constitutes fraud, there is no simple definition. Intent to defraud creditors does not seem to be an essential element.[19] If the subsidiary had insufficient capitalization to operate its

15. *U. S. v. Anderson*, 269 U. S. 422 (1926).
16. *Bartle v. Home Owners Cooperative*, 309 N. Y. 103, 127 N. E. 832 (1955).
17. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CAL L. REV. 12, 15 (1925).
18. *Ibid.* See also Douglas and Shanks, *Insulation from Liability through Subsidiary Corporations*, 39 YALE L. J. 193.
19. "It should not be necessary that an actual intent to freeze out creditors appear in order to impose liability." LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS, 140 (1936).