1962

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Recommended Citation
Robert H. Mow Jr., Professional Associations and Professional Corporations, 16 Sw L.J. 462 (1962)
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COMMENTS

PROFESSIONAL ASSOCIATIONS AND PROFESSIONAL CORPORATIONS

Robert H. Mow, Jr.

For several years the organized professions in the United States have waged a battle for tax equality under the internal revenue codes.¹ Until 1961 these efforts had produced little except frustration; however, since that time, there has been a veritable shower of new state statutes dealing with this problem.² The new enactments purport to grant the desired relief through anomalous creatures called "professional associations" and "professional corporations." The purpose of this Comment is to analyze the new statutes critically in their legal and ethical contexts.

For the sake of brevity, the following terms will hereafter be used as defined:

(a) articles—The Articles of Association or the Certificate of Incorporation.

(b) certificate—A certificate issued by a state board³ which acknowledges the registration of a professional corporation or professional association and approves the named stockholders or members as duly licensed practitioners of that profession.⁴

(c) employees—Persons in the professional corporation or professional association who render the professional services. Administrative assistants such as secretaries and bookkeepers are not included within this term.⁵

(d) Kintner Regs—The 1960 Treasury Regulations which provide the tests for determining when an organization can be taxed as a corporation.⁶

(e) professional man or practitioner—A licensed person who is considered to be practicing a learned profession under the

² See infra the Chart. For the purposes of this Comment, Texas has been classified as a state which allows the formation of a professional association. For the views of the draftsman of the Texas provision see Bromberg, Texas Uniform Partnership Act—The Enacted Version, 15 Sw. L.J. 386, 387-89 (1961).
³ See "(g)," which follows in the text.
laws of a particular state and under the regulation of a state board. The phrase usually includes, but is not necessarily limited to, such persons as accountants, dentists, lawyers, and physicians. As to whether other professions, such as optometry, are included, the laws of each particular state must be consulted. The terms do not include tradesmen such as electricians, barbers, or plumbers.

(f) professional relationship—The relationship of trust and confidence which exists between an individual practitioner and his client or patient.

(g) state board—The particular group or groups within each state which regulate and govern the activities, ethics, and licensing of a particular profession, e.g., a medical licensing board and a state supreme court.

I. Background

For years professional men have objected to internal revenue code provisions which discriminate against the self-employed. The provisions objected to are those which grant substantial tax-savings in the area of deferred compensation and profit sharing plans solely to those persons who are employed by others. Under current law, for example, an employer can establish a “qualified” employee pension or profit sharing plan and deduct all payments which are made to that plan. The trust which holds these funds and accumulates income is not taxed, and the beneficiary-employee is taxed only when the benefits are distributed at his death or retirement—and then possibly at capital gain rates. Even principal shareholders of a corporation can reap these benefits since they can qualify as employees and thereby participate in the plans. However, professional men have been denied similar benefits for two reasons: first, state laws and ethical considerations have prevented them from incorporating; and second, federal tax laws have prevented partners of a professional partnership (the type of business association most common among practitioners) from considering themselves as em-
ployees of the partnership for purposes of establishing a qualified pension or profit sharing plan. Accordingly, a practitioner is not allowed a deduction for funds contributed to a retirement plan; the funds cannot grow through tax-free accumulation; and they cannot be recovered at capital gain rates.

Practitioners have attempted in two ways to eliminate this inequality. The more direct approach has consisted of efforts to amend the pertinent portions of the Internal Revenue Code to authorize qualified pension and profit sharing plans for self-employed persons. These efforts have been evidenced by the Keogh Bill, which in the most recent form would allow any self-employed individual to consider himself his own employee for purposes of establishing a qualified plan. Under this bill a self-employed person would be permitted to deduct the lesser of ten per cent of his income or $2,500 per year to set aside tax free for investment in a pension plan; however, the bill fails to provide capital gain opportunities for the beneficiary when he receives the money. Because of past opposition from the Treasury Department—motivated by fear of a loss of revenue—the Keogh Bill has never been enacted. Since the current Bill incorporates several changes suggested by the Treasury itself, a similar measure may be adopted in the near future. However, to date this approach has offered no relief to practitioners.

The second, less direct approach to the problem has been represented by efforts to create organizations which under state law would be treated as partnerships but which under the Internal Revenue Code would be classified as associations and, therefore, taxed as cor-

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15 Pension and profit sharing plans are normally not very attractive to any partnerships due to the requirement that payments to the plan be made for the sole benefit of the employees. See Int. Rev. Code of 1914, § 401(a). This precludes general partners since they cannot qualify as employees, Rev. Rul. 61-117, Part 2(c)(1), 1961-36 Int. Rev. Bull. 9; I.T. 3330, 1940-1 Cum. Bull. 64, and as an employer, a partner cannot participate in the plan, P.S. No. 23 (1944); Rev. Rul. 33, Part 2 (b) (1), 1953-1 Cum. Bull. 267, 269.


18 For a good history of these attempts see Rapp, supra note 1; see Rapp, supra notes 1, 16.

19 E.g., making the pension plan cover other employees of the self-employed, allowing self-employed to treat themselves as their own employees thereby keeping the plan within the framework of §§ 401-04 of the Code. See Rapp, supra notes 1, 16, and Hearings on Pension Plans for Owner-Managers of Corporations Before the Senate Finance Committee, 86th Cong., 2d Sess. 2 (1960).
The 1954 case of *United States v. Kintner*, which permitted an association of doctors to be taxed as a corporation, aroused hopes that this method would be successful. However, the Treasury indicated that it would not follow the *Kintner* ruling and that it would publish its own list of criteria to use in determining whether an organization could be taxed as a corporation. Regulations were proposed in December 1959 and finally promulgated in November 1960. Even though the Regulations came soon after *Galt v. United States*, where another association of doctors obtained court approval for tax treatment as a corporation, they indicated that the Internal Revenue Service did not intend to allow "Kintner associations" to be taxed as corporations. Consequently, in the latter part of 1960, practitioners were faced with bleak prospects in their search for tax equality via this approach.

The reason for forming an association which would be treated as a partnership under state law was to avoid the legal prohibitions on incorporation by professionals, see cases cited notes 143, 151, 161, and 178 infra, yet still qualify for corporate tax treatment under the internal revenue codes. An association may be taxed as a corporation under Int. Rev. Code of 1954, § 7701(A)(3), which reads: "Corporation—the term 'corporation' includes associations, joint-stock companies, and insurance companies." Previous revenue and tax acts contained identical definitions. See Rev. Act of 1918, § 1; Rev. Act of 1926, § 2(a)(2); Int. Rev. Code of 1939, § 3797(a)(3).

Initially it was the Commissioner who was successful in asserting that associations of professional men with numerous corporate characteristics would be taxed as corporations. See Pelton v. Commissioner, 82 F.2d 473 (7th Cir. 1936) (a business trust composed of doctors held taxable as a corporation). For situations where non-professional taxpayers were likewise unsuccessful in retaining state classifications as partnerships under the federal tax laws see Burk-Waggoner Ass'n v. Hopkins, 269 U.S. 110 (1925) (unincorporated joint-stock company treated as a partnership under Texas law was held taxable as a corporation under federal law); Wholesalers Adjustment Co. v. Commissioner, 88 F.2d 156 (8th Cir. 1937); cf. Tyrrell v. Commissioner, 91 F.2d 500 (5th Cir.), cert. denied, 302 U.S. 747 (1937). Recently the same argument has been used with success against the Commissioner. See cases cited notes 22, 27 infra.

The purpose in seeking to be taxed on income as a corporation is that all other corporate tax consequences follow, e.g., the right to establish qualified pension plans. See Tyrrell v. Commissioner, infra at 101. For other tax advantages which can be gained by a corporate-type organization see Eber, *Professional Service Corporations*, 100 Trusts & Estates 758 (1961); Wilson, *Professional Associations Taxable as Corporations*, 5 Texas 8th Inst. on Current Tax Hazards 1 (1960); P-H Pens. & Prof. Sh. Rep. ¶ 44.1 (1961).

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The final Regulations were promulgated only a short time before the first "professional corporation" statute was enacted. Indeed, it was no accident that there was such proximity in time, for a combination of two stimulants, one originating in the Treasury Regulations, and one emerging from the professions, induced the state legislatures to take immediate action.

The first stimulant consisted of the emphasis which the final Regulations placed on state law in determining the tax status of unincorporated associations. For tax purposes classification of an organization as a corporation ordinarily depends on federal law. Similarly, in order to ascertain what constitutes a "tax corporation" under the Regulations, one must look to six criteria which federal courts have considered indicative of the true nature of a corporation. However, in an attempt to clarify further the tests to be used, the Regulations provide that state law will determine whether an organization has the necessary internal relationships to comply with each of the six criteria. Therefore, the controlling question in every instance is: What do the state laws permit? Thus, in late 1960 corporate tax status for professional men appeared to be no further away than the modification of existing state statutes to permit the necessary internal relationships.

The second stimulant consisted of the enthusiastic efforts on the part of the lobbies of professional societies to secure passage of the statutes. Several factors motivated this enthusiasm. First, there was a general feeling of frustration because of the failure of the Congress to enact the "Keogh Bill" and thereby to give professional men some measure of tax relief. Second, there was undoubtedly resent-

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29 South Dakota enacted the first statute on Feb. 25, 1961.
30 See, e.g., United States v. Kintner, 216 F.2d 418, 424 (9th Cir. 1954). Indeed, the Regulations themselves assert this principle. Treas. Reg. § 301.7701-1(c) (1960).
31 The landmark case which first established the rudiments of the current tests was Morrissey v. Commissioner, 296 U.S. 344 (1935), where a "trust" organized to operate a golf course was classified as an association and taxed as a corporation at the instance of the Commissioner. The Supreme Court found the "trust" was more like a corporation because (1) it was a joint enterprise for the transaction of business, (2) it had centralized management, (3) it had continuous life in spite of the death of the beneficiaries, (4) interests in the trust could be transferred, and (5) the beneficiaries had limited liability. These same criteria were used by other cases following Morrissey. See, e.g., United States v. Kintner, supra note 30, at 421-24; Tyrrell v. Commissioner, 91 F.2d 500, 501 (5th Cir.), cert. denied, 302 U.S. 747 (1937); Pelton v. Commissioner, 82 F.2d 473 (7th Cir. 1936).
32 Treas. Reg. § 301.7701-1(c) (1960).
33 The American Medical Association was very helpful in producing the quick results. That organization drafted and sent to all of its state societies a model bill for enactment of a professional corporation law. This may explain the many similarities among the statutes. See Report of the Law Department of the Legal and Socio-Economic Division of the Board of Trustees of the AMA, 178 J.A.M.A. 170 (1961).
ment toward the Treasury Department because of its efforts to repudiate the "Kintner associations." Third, there had already been specific proposals for new enactments which would permit formation of "professional associations" and "professional corporations." Therefore, it is not surprising that when the Treasury indicated that state law would play a vital role in obtaining corporate tax treatment for professional organizations, representatives of the professions were well equipped to encourage the necessary legislation.

II. CURRENT TAX ASPECTS OF A PROFESSIONAL ASSOCIATION OR PROFESSIONAL CORPORATION

The Kintner Regulations specify six "major" corporate characteristics which are to be used to determine if an organization will be classified as a partnership or as a corporation for tax purposes. To be considered a "corporation" under the Regulations, an organization should have the following "major" characteristics: (1) "associates" in the business; (2) an objective to carry on a business for joint profit; (3) continuity of life; (4) centralization of management; (5) limited liability; and (6) free transferability of interests. Because the first two criteria are considered common to both partnerships and corporations, the crucial characteristics are the remaining four. Therefore, in order to be taxed as a corporation, an organization must be more corporate than non-corporate in nature as measured primarily by those four criteria.

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30 See generally the sources cited note 1 supra.
31 See Jones, supra note 1 (Many of the suggestions made by Jones have been adopted in the recent statutes); Jones, Should Lawyers Incorporate? 11 Hastings L.J. 150 (1960); Wormser, supra note 1.
32 "There are a number of major characteristics ordinarily found in a pure corporation which, taken together distinguish it from other organizations." Treas. Reg. § 301.7701-2(a)(1) (1960).
33 Treas. Reg. § 301.7701-2(a)(2) (1960). It should be noted that the author is not necessarily in agreement with the Treasury that the "characteristics" listed are "distinguishing" features of a corporation. Indeed, some types of corporations may not have one or more of these "major" characteristics. For example, a non-profit corporation obviously is not designed to produce a profit; and, therefore, it cannot qualify as a "tax corporation" since it lacks the characteristic of "an objective to carry on a business for joint profit." See Treas. Reg. § 301.7701-2(a)(2) (1960). Yet it is nonetheless a corporation. Moreover, a non-profit corporation probably will not have "free transferability of interests" since by its nature it may not even have "interests." See Texas Non-Profit Corporation Act art. 2.24 (Supp. 1961). Furthermore, it is not inconceivable that there be individual liability of shareholders in a corporation. See 1 Fletcher, Private Corporations § 20 (perm. ed. 1931); Liverpool Ins. Co. v. Massachusetts, 77 U.S. (10 Wall.) 566 (1870). Finally, there certainly may be corporations with restrictions on the "free" transferability of shares, especially in a closely-held organization. See 1 Fletcher, supra; Palmer v. Chamberlin, 191 F.2d 532 (5th Cir. 1951). While some such restrictions may be considered "unreasonable," it is normally the restriction which is declared invalid, and not the corporation.
After the promulgation of the Regulations in 1960, there was the immediate reaction by professional groups on the state level. In 1961 special bills were introduced in twenty-two legislatures. Fourteen states subsequently enacted laws which appeared to satisfy the tax requirements through the creation of professional associations and professional corporations. In subsections A and B of this section, an attempt will be made to analyze these new statutes graphically and critically vis-à-vis the Treasury Regulations.

A. The State Laws—Examined Graphically

This subsection deals with the graphical analysis. Therefore, in the Chart on the following pages the provisions of the statutes of each state are classified according to their relation to one of the four "major" corporate characteristics which are considered to be crucial under the Kintner Regulations.

B. The State Laws And The Treasury Regulations—Analyzed Critically

In this subsection the following form is used: first, one of the four "major" corporate criteria is in part reprinted from the Regulations; second, that particular criteria is discussed briefly; third, the state statutes are analyzed with respect to their satisfaction of that criteria.

1. Continuity of Life

(1) An organization has continuity of life if the death, insanity,
bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization. On the other hand, if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the organization, continuity of life does not exist.

(2) For purposes of this paragraph, dissolution of an organization means an alteration of the identity of an organization by reason of a change in the relationship between its members as determined under local law. For example, since the resignation of a partner from a general partnership destroys the mutual agency which exists between such partner and his copartners and thereby alters the personal relation between the partners which constitutes the identity of the partnership itself, the resignation of a partner dissolves the partnership. A corporation, however, has a continuing identity which is detached from the relationship between its stockholders.\(^4\)


**a. Comments on the "Continuity" Requirement.**—This requirement has been criticized for taking a somewhat technical viewpoint,\(^4\) one that is inconsistent with *Galt v. United States*\(^5\) and the Uniform Partnership Act (hereafter referred to as the "UPA"). The objection is that the Treasury has placed too much emphasis upon an individual member's power to "dissolve" the partnership and too little emphasis upon the fact that in the vast majority of cases a partnership does not lose its identity nor its right to carry on business just because of a "dissolution."\(^6\) Though there are many ways by which a partnership may be "dissolved" under the UPA, in most instances the organization which remains after "dissolution" may legally continue to transact business (until termination and liquidation) if the agreement so provides.\(^7\) Thus, in spite of the power of

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\(^{4}\) Treas. Reg. § 301.7701-2(b) (1960).


\(^{6}\) United States v. Kintner, 216 F.2d 418 (9th Cir. 1954).

\(^{7}\) See MacKay, supra note 45, at 422-23.
<table>
<thead>
<tr>
<th>STATE</th>
<th>TYPE</th>
<th>CONTINUITY OF LIFE</th>
<th>CENTRALIZATION OF MANAGEMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALA.¹</td>
<td>1) Ass'n § 1</td>
<td>1) Continues despite death, insanity, resignation, or bankruptcy of a member until dissolved by a 2/3 vote of the members. § 8.</td>
<td>1) Governed by a Board of Gov elected by members, and by elected by the Board. § 7.</td>
</tr>
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<td></td>
<td>2) All § 2</td>
<td>2) No member can dissolve, nor does transfer of stock dissolve. § 8.</td>
<td>2) No member can bind the association within the scope of the association. § 7.</td>
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<td>3) The Attorney General may dissolve for failure of the association to remove a disqualified member or employee. § 10.</td>
<td>3) Members of the Board and officers not be members of the association.</td>
</tr>
<tr>
<td>ARK.²</td>
<td>1) Corp. § 2</td>
<td>1) The BCA is applicable to these corporations. § 3. (Business Corporation Act)</td>
<td>1) The organization is governed by the BCA, and all powers, privilege duties are determined by this statute.</td>
</tr>
<tr>
<td></td>
<td>2) Dentists &amp; Physicians § 2</td>
<td>2) Annual registration and renewal of the certificate is required. § 6.</td>
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</tr>
<tr>
<td>CONN.⁴</td>
<td>1) Ass'n § 34-82(1)</td>
<td>1) The Articles must provide &quot;continuity of life so that the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution.&quot; § 34-82(1)(a).</td>
<td>1) The Articles must provide &quot;continuity of management so that any one of the members or less than all of the members of the corporation, acting without the authority of the managing member or managing agent, shall have the power to bind the corporation by his act.&quot; § 34-82(1)</td>
</tr>
<tr>
<td></td>
<td>2) All § 34-82(1)</td>
<td>2) The Articles shall be cancelled &quot;when the association is dissolved by all of its members or as otherwise provided in the Articles.&quot; § 34-82(4).</td>
<td></td>
</tr>
<tr>
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<td></td>
<td>3) Before dissolution is effective the agreement of such action must be filed with the Secretary of State, and filed for record with the town clerk. § 34-82(1).</td>
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</tr>
</tbody>
</table>

¹ All Alabama section numbers refer to the Professional Ass'n Act, 2 P-H Corp. Serv. Ala, 221-24 (1961).
³ The state board may revoke the certificate for:
  1) failure of the corporation to remove a disqualified member, agent, officer, or employee;
  2) failure of the corporation to remove any person guilty of unethical conduct;
  3) lack of surviving shareholders, i.e., death of the last shareholder;
  4) failure of the corporation to comply with state board regulations.
NSFERABILITY OF INTERESTS

members or shareholders must be licensed. § 9.
res of stock or certificates of membership are freely transferable unless the cles otherwise lawfully restrict. § 9.

LIMITED LIABILITY

1) The professional relationship is to remain unchanged. § 6.
2) There is no individual liability for debts of, or claims against the association, unless the individual personally participated in the transaction. § 6.

"officers, directors, and shareholders" it be licensed. No unlicensed person have any part in the ownership, management, or control of the corporation. § 14.
there is no other provision except that corporation enjoys the powers and privileges given under the BCA. § 3.

1) The act does not alter "any law applicable to the relationship between a dentist (doctor) furnishing dental (medical) service and a person receiving such service, including the liability arising out of such service." § 15.
2) The BCA controls in areas not otherwise specified in the act. § 3.

1) The Articles must provide "limited liability so that the individual members of the association shall not be individually or severally liable for its debts; provided, however, the members shall in no way limit their individual or several liability in the Articles of Association or otherwise, for any acts of reckless or wanton conduct, negligence, malpractice, professional misconduct or tort." § 34-82(1)(c).

Articles must provide one of two:
"free transferability" so that the dominant interest-holding members may transfer to an unassociated licensed person without the consent of others; or "modified transferability" so that after first offering to current members at fair market value, a member may then transfer to an unassociated licensed person. § 34-82(1)(d).
<table>
<thead>
<tr>
<th>STATE</th>
<th>CONTINUITY OF LIFE</th>
<th>CENTRALIZATION OF MANAGEMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) TYPE</td>
<td>1) The corporation has perpetual succession by corporate name unless a limited period is stated in the Articles. § 33-428 (c).</td>
<td>1) The organization could have type management as any no corporation under the Non-Stock Corp. Act. §§ 33-442 to -45.</td>
</tr>
<tr>
<td>2) OPEN TO</td>
<td>2) There may be dissolution by a) resolution; b) expiration of the period specified in the Articles; c) decree of dissolution in judicial proceedings to liquidate; d) forfeiture action by the Secretary of State or quo warranto by the Attorney General. § 33-484.</td>
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<tr>
<td>CONN.⁹</td>
<td>1) Corp. § 33-180</td>
<td>1) Organizational aspects of the corporation are governed by the business corporation laws. §§ 5, 13.</td>
</tr>
<tr>
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<td>2) Physicians § 33-180</td>
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<tr>
<td>FLA.⁸</td>
<td>1) The corporation would have the same existence as any business corporation under Florida law. §§ 5, 13.</td>
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<td>2) All § 3</td>
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<td>2) Failure to remove a disqualified officer, shareholder, agent, or employee is a ground for forfeiture of the Articles. § 10.</td>
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</tr>
<tr>
<td>GA.⁷</td>
<td>1) Unless the Articles provide otherwise the association continues until dissolved by a vote of the members or expiration of the stated term. No member has the power to dissolve. § 9.</td>
<td>1) The association is governed by duly elected by the members: officers elected by the Board &quot;centralization of management assured.&quot; § 8.</td>
</tr>
<tr>
<td></td>
<td>2) The organization is a separate entity apart from its members, and neither death, insanity, incompetency, conviction for a felony, resignation, withdrawal, transfer of membership, retirement, nor expulsion of a member affects the business life. § 9.</td>
<td>2) No member has power to bring association within the scope of business or profession solely by his being a member. § 8.</td>
</tr>
<tr>
<td></td>
<td>3) Failure to remove an unlicensed or disqualified employee is a ground for dissolution by the Attorney General. § 11.</td>
<td>3) Officers have the power to employ agents &quot;as they may deem advisable provided they are licensed if the to render professional service. §</td>
</tr>
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<thead>
<tr>
<th>SFERABILITY OF INTERESTS</th>
<th>LIMITED LIABILITY</th>
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<tbody>
<tr>
<td>licensed persons may be employees of the corporation. §§ 33-30-181.</td>
<td>1) Under the Non-Stock Corporation Act members are under no obligation to the corporation or its creditors other than the obligation to pay fines, dues, etc. § 33-472(a).</td>
</tr>
<tr>
<td>as otherwise provided in the certificate of incorporation a member may voluntarily or involuntarily transfer membership or any rights arising therefrom. Non-Stock Corp. Act § 33-1.</td>
<td></td>
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<tr>
<td>transfer must be made to a licensed person. §§ 3 (2), 9, 11.</td>
<td>1) Nothing in the act changes in any way the &quot;professional relationship and liabilities between the person furnishing the professional services and the person receiving such professional service. . . .&quot; § 7.</td>
</tr>
<tr>
<td>transfer may be made by any shareholder unless a majority of the remainder of the shares are voted in favor of the transfer. The action must be taken at a shareholders' meeting called specially for the purpose. § 11. Articles may provide additional restrictions on transferability. § 11.</td>
<td>2) Any officer, shareholder, agent, or employee remains personally liable for negligence or misconduct he committed or someone &quot;under his direct supervision and control&quot; committed in rendering the service. § 7.</td>
</tr>
<tr>
<td>stock or membership is freely transferable unless the Articles otherwise provide. § 10.</td>
<td>1) The Act does not change any law applicable to the professional relationship, including the liability arising therefrom. § 7.</td>
</tr>
<tr>
<td>2) Members or shareholders are not individually liable for debts of or claims against the association &quot;unless such member . . . has personally participated in the transaction.&quot; § 7.</td>
<td></td>
</tr>
</tbody>
</table>
1) STATE
2) CENTRALIZATION OF MANAGEMENT
   1) TYPE
   2) OPEN TO

   ILL.
   1) Ass'n § 101
   2) All § 101

   M N N.
   1) Corp. § 319.02
   2) Physicians § 319.02 (2)

   O H I O
   1) Ass'n § 1785.02
   2) All § 1785.02

   1) The Articles may provide that the association will continue as a separate entity independent of its members for the period of time provided in the Articles or until dissolved by a vote of 2/3 of the members. § 107.

   2) Death, insanity, incompetency, conviction of felony, resignation, withdrawal, transfer of membership, retirement or expulsion of any one except the last member, admission of new members, or any like event which would dissolve a partnership, shall not affect the life of the association. § 107.

   3) The Articles may provide that no member shall have the power to dissolve by his act. § 107.

   1) Management is the same as that of the BCA or under the Non-Profit Corporation Act. §§ 319.03, .05.

   2) No member has the power to association merely by virtue of being a member. § 108.

   3) Members may adopt by-law Articles may give this power. § 108.

   4) The officers may employ such they deem advisable. § 108.

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1) The corporation may organize under the BCA or under the Non-Profit Corporation Act and enjoy the same rights and privileges as other corporations under those acts. § 319.05.

2) The State Board has rigid control over the corporation and may deny a certificate of registration on the annual application for a) failure to remove any unlicensed employee or director, b) lack of surviving licensed members, or c) failure of the corporation to comply with State Board regulations. §§ 319.07 -.12.

1) "Chapter 1701 of the Revised Code (General Corporation Law) shall be applicable to professional associations, including their organization and the manner of filing articles of incorporation."

2) Organization is governed by the general corporation law. § 1785.

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11 From the wording of the Ohio statute it is difficult to tell what type organization is intended. The act refers in most places to an "association," but calls for "incorporation" and control under the general corporation laws.
SFERABILITY OF INTERESTS

1) "This act does not alter any law applicable to the relationship between a person furnishing professional service and a person receiving such professional service including liability arising out of such professional service." § 109.

LIMITED LIABILITY

1) The Act does not alter any law applicable to the professional relationship, including liability arising out of such service. § 106.

1) The Act does not alter any law applicable to the relationship between a person furnishing professional service and a person receiving such professional service including liability arising out of such professional service." § 106.

1) The Act does not modify any law applicable to the professional relationship, including liability arising out of such service. § 1785.04.

1) The Act does not alter any law applicable to the professional relationship, including liability arising out of such professional service. § 319.16.

1) The Act does not modify any law applicable to the professional relationship, including liability arising out of such service. § 1785.04.
<table>
<thead>
<tr>
<th>STATE</th>
<th>TYPE</th>
<th>CONTINUITY OF LIFE</th>
<th>CENTRALIZATION OF MANAGEMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>OKLA.</td>
<td>Corp. § 804</td>
<td>1) The BCA applies to these corporations and controls all powers, privileges, duties, restrictions, and liabilities. § 805.</td>
<td>1) Management is likewise controlled by the BCA. § 805.</td>
</tr>
<tr>
<td>PENN.</td>
<td>Ass'n § 3</td>
<td>1) The association is organized for a term of years, or in perpetuity. &quot;Neither death, bankruptcy, resignation, expulsion, insanity, retirement, nor transfer or redemption of the interest of any associate shall cause its dissolution.&quot; § 14.</td>
<td>1) The associates elect a Board which manages all association affairs. Board elects whatever officers it deems necessary, establishes the amount of excess distribution of assets. §§ 8-10.</td>
</tr>
<tr>
<td>PENN.</td>
<td>All § 2(2)</td>
<td>2) The association can only be dissolved by: a) expiration of the term of existence; or b) majority vote of associates, voting according to proportionate shares. § 19.</td>
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</tr>
<tr>
<td>PENN.</td>
<td>Physicians § 2</td>
<td>2) All § 2(2)</td>
<td>3) The Board hires whatever employees it deems necessary, establishes the amount of excess distribution of assets. §§ 8-10.</td>
</tr>
<tr>
<td>S.D.</td>
<td>Corp. § 2</td>
<td>1) The private corporation laws apply to these corporations and control all powers, privileges, duties, restrictions, and liabilities. § 3.</td>
<td>1) Management is controlled by the corporation laws. § 3.</td>
</tr>
<tr>
<td>PENN.</td>
<td>Ass'n § 61-105</td>
<td>1) The Articles must provide in substance that the death, insanity, bankruptcy, resignation, expulsion or withdrawal of any member of the association shall not cause its (the association's) dissolution. § 61-105 (a).</td>
<td>1) The Articles must provide in substance that &quot;the authority to manage the affairs of the association shall rest in a board of directors, or an employee, or committee elected members of the association. § 105 (b).</td>
</tr>
<tr>
<td>PENN.</td>
<td>All § 61-105</td>
<td>2) All § 61-105</td>
<td>1) The Articles must provide in substance that &quot;the authority to manage the affairs of the association shall rest in a board of directors, or an employee, or committee elected members of the association. § 105 (b).</td>
</tr>
</tbody>
</table>

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19 Oklahoma specifically lists which professions may incorporate. Consult § 803 for details.
21 All South Dakota section numbers refer to the Medical Corp. Act, 4 P-H Corp. Serv. S.D. 87-88 (1961).
22 The same grounds are given as are found in the Arkansas statutes. See note 3 supra.
Nonsferability of Interests  

LIMITED LIABILITY

Shares may be issued and subsequently transferred only to licensed persons. Any voluntary transfer is null and void. § 809.

§ 809.

Shares may be transferred upon the consent of the professional corporation or its directors . . . until there is presented to the corporation a certificate by the regulating board assuring that the proposed transferee is duly licensed. § 809.

1) The Act does not alter any law applicable to the professional relationship, including the liability arising out of such services. § 812.

§ 812.

y transferee must be duly licensed. 2.

is implied that the by-laws may contain additional restraints on transferability. § 12.

1) “All of the associates . . . are liable, jointly and severally, for—

a) the torts of any agent or employee of the Association committed while . . . acting within the ordinary course of operation of the Association;

b) the misapplication by any associate of any money or property of a third person if . . . received . . . in the ordinary course of its operation.” § 17.

2) “All associates . . . are liable, jointly, for all debts and legal obligations of the association other than those chargeable under clauses (a) and (b)” above. § 17.

unlicensed person can be a shareholder or have any part in management control of the corporation. § 14.

1) The act does not alter any law applicable to the professional relationship, including the liability arising from any services. § 15.

Articles must provide in substance that “the members of the association shall not be personally liable for debts of, or claims against the association.” § 61-105(d).

1) The Articles must provide in substance that “the members of the association shall not be personally liable for debts of, or claims against the association.” § 61-105(c).
<table>
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</tr>
</thead>
</table>
| TExAs | 1) The Texas provision reads as follows: "(3) An association is not a partnership under this act if:
   a) the word 'association' or 'associates' is part of and always used in the name under which it transacts business, and
   b) its assumed name certificates... contain a statement substantially as follows: 'This association intends not to be governed by the Texas Uniform Partnership Act,' and
   c) the business it transacts is wholly or partly engaging in an activity in which corporations cannot lawfully engage." § 6(3). |
|      | 2) All | |
| WISc. | 1) The corporation is generally governed by, and has all the rights and liabilities under, the business corporation laws. § 180.99(3). |
|      | 2) The corporation will have perpetual existence except that the franchise may be suspended or forfeited for failure to remove a disqualified shareholder, officer, director, or employee. §§ 180.99(6), .99(10)(a). |
|      | 1) Management will be the same as business corporation. § 180.99(1). |

<table>
<thead>
<tr>
<th>ISFERABILITY OF INTERESTS</th>
<th>LIMITED LIABILITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is no statutory provision except previously cited.</td>
<td>1) The Act does not alter “any contract, tort or other legal relationship between a person receiving professional services and . . . persons who are licensed . . . to render such services and who are shareholders . . . ; and any legal liability which may arise out of such service shall be joint and several among the shareholders.” § 180.99(8).</td>
</tr>
<tr>
<td>Shareholders, directors, and officers be licensed. § 180.99(6).</td>
<td>2) “No shareholder, director, officer, or employee of a service corporation shall be personally liable for the debts or other contractual obligations of the corporation.” § 180.99(8).</td>
</tr>
</tbody>
</table>
an individual partner to cause a "dissolution," even the UPA recognizes that "dissolution" is a technical concept, and that it has little actual effect on the "continuity of life" of the organization. Similarly, the Kintner and Galt cases seem impliedly to acknowledge that an association may by contract be endowed with continuous life, even though that association is considered a partnership under state law. Therefore, by requiring that a member of an association must not be able to cause its "dissolution" under state law—even though a "dissolution" has very little effect on the actual life of the organization—the Regulations ignore the de facto and de jure continuation of that organization.

Apparently the Treasury has taken a position which is inconsistent with the Internal Revenue Code of 1954 with respect to the duration of the life of a partnership. Under section 708(b) and corresponding Regulations, if a partnership continues to transact business after "dissolution," it continues to be a partnership. Thus, it seems that for purposes of determining "continuity of life," the Treasury considers a "dissolution" to be controlling; whereas, for purposes of determining the existence of a partnership for all other tax purposes, a "dissolution" is a mere technicality.

Under the KintnerRegs, "continuity of life" does not seem to be a prerequisite to taxation as a corporation. In Example 6 of the Regulations, the organization in question obviously has no "continuity of life," yet it is classified as an association because of the presence of the other three characteristics.

b. Comments on the New Statutes.—As the Chart illustrates, most states did not question the Treasury's interpretation of the UPA
but acquiesced therein by making express provisions for continuous life in their organizations. Where statutes specify that the death, retirement, lunacy, bankruptcy, or expulsion of a member or shareholder will not cause a "dissolution," or where the business corporation laws of a state are permitted to govern, there should be little question as to the power of a professional organization to continue despite a change in membership. In these instances the life of the organization clearly is not coextensive with the lives of the individual members or shareholders. Thus, there appears to be no way for an individual member or shareholder to destroy the "identity" of the organization as a partner may do in a partnership.  

The statutes in Connecticut, Tennessee, and Texas do not expressly endow the professional associations with continuous life. Rather, the Connecticut and Tennessee statutes require only that the articles incorporate this feature, and the Texas statute does nothing more than exclude any potential professional association from the jurisdiction of the UPA. It is questionable whether these provisions are sufficient to establish the "continuity" characteristic since they merely relegate an association to common law precedents in order to ascertain if an association possesses such an attribute. Admittedly, there is authority implying that a professional association at common law has continuous life; however, in any small professional association, the loss of even one practitioner will normally result in a realignment of the remaining members and, consequently, of their legal relationships. In effect, it appears that there is a change in the "identity" of the association similar to the change which occurs in the "identity" of a partnership on the death, retirement, or bankruptcy of a partner. Therefore, without statutory authorization for a professional organization to continue unaffected by the loss of a member, there may be some question as whether the "continuity" criteria, as interpreted by the Regulations, is satisfied.  

It should be noted that even without more specific statutory provisions, the Connecticut, Tennessee, and Texas associations may

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55 E.g., Alabama. See supra the Chart.  
56 E.g., Arkansas. See supra the Chart.  
57 Since by the express statutory language there is (1) no mutual agency and (2) no "dissolution" on the death, insanity, bankruptcy, or retirement of a member, the requirements of the Treasury Regulations seem to be satisfied—i.e., that there be a "continuing identity."  
59 See supra the Chart for a summary of these states' provisions.  
60 It seems to be the prevailing view that a common law association can have continuous life. Tyrrell v. Commissioner, 91 F.2d 709, 701 (5th Cir.), cert. denied, 102 U.S. 747 (1937); Dodd, Dogma and Practice in the Law of Associations, 42 Harv. L. Rev. 977 (1929).
compare favorably with the medical clinic approved for corporate taxation in the first example in the Regulations—an assuming, of course, that the articles provide for continuous life.

Another problem may arise if the Treasury should require the professional corporations to prove that they are corporations under the tax laws.62 The problem is whether a statutory requirement that a professional corporation procure an annual certificate will destroy the characteristic of "continuity of life."63 Since the existence of the corporation is not directly tied to the continued participation of a particular shareholder, in one sense there is "continuity." However, the corporation can lose its right to function in certain states if for some reason, e.g., disqualification of a shareholder to practice, the certificate cannot be renewed. In this respect the life of the professional corporation is coextensive with the continuing participation in the corporation of an individual shareholder.64

2. Centralization of Management

(1) An organization has centralized management if any person (or any group of persons which does not include all the members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed. . . .

(2) . . . .

(3) Centralized management means a concentration of continuing exclusive authority to make independent business decisions on behalf of the organization which do not require ratification by members of such organization. . . .

(4) There is no centralization of continuing exclusive authority to make management decisions, unless the managers have sole authority

61Treas. Reg. § 301.7701-2(g) (Example 1) (1960).
62A Florida CPA concludes that the Commissioner will not question an organization whenever it has been incorporated and registered with the Secretary of State on the theory that the Regulations were intended to deal with the more nebulous organizations which were neither a corporation nor a partnership. Eber, The Pros & Cons of the New Professional Service Corporations, 15 J. Taxation 308 (1961). An attorney in the October 1961 issue of the same magazine likewise felt that the Internal Revenue Service would treat these "corporations" at face value. Maier, Don't Confuse Kintner-type Associations with New Professional Corporations, 15 J. Taxation 248 (1961). However, see Bittker, Professional Associations and Federal Income Taxation: Some Questions and Comments, 17 Tax. L. Rev. 1 (1962), and Comment, 75 Harv. L. Rev. 776, 784-85 (1962) for contrary views. It does seem doubtful that the Commissioner will permit himself to be so bound by state law that he cannot look behind the label "corporation" to see if the organization is in law a corporation.
63Arkansas, Connecticut (group medical clinic), Minnesota, Oklahoma, and South Dakota require certificates. See sources cited notes 3, 5, 9, 12, and 16 supra the Chart, and the accompanying text.
64The Oklahoma statute goes further than just specifying an annual certificate. It requires the corporation to secure from the State Board a certificate which approves each prospective shareholder or member. No penalties are provided for a failure to do so, however. See Professional Corp. Act, Okla. Stat. Ann. tit. 18, § 809 (Supp. 1961).
to make such decisions. . . . Because of the mutual agency relationship, a general partnership cannot achieve effective concentration of management powers, and therefore, centralized management. . . .

a. Comments on the “Centralization” Requirement.—The interpretation given this characteristic is particularly restrictive upon states which have enacted the UPA, because under that act all partners have equal rights in the management of the business, though they may waive these rights by an agreement. However, even if there is a contract under which certain partners are to act as sole managers, as to third persons without notice every partner remains an agent of the partnership. Therefore, the “centralization” required by the Regulations is nearly impossible to obtain wherever the UPA is in force.

One noteworthy provision of the Regulations is that persons managing the professional association or professional corporation need not be members or shareholders of that organization. Several states have incorporated such a feature into their acts—albeit at the risk of incurring objections on ethical grounds.

In all of the examples in the Regulations in which organizations are classified as associations, “centralization of management” is present. Undoubtedly this is an essential characteristic, since it is indeed difficult to imagine an entity similar in form to a corporation which does not have such a feature.

b. Comments on the New Statutes.—Most states adequately endow their professional organizations with the feature of “centralized management.” All of the “corporation” states, and Alabama, Georgia, and Ohio of the “association” states, permit the professional corporation or professional association to utilize the organizational structure of the local business corporations. This approach seems to satisfy the Treasury’s requirement that there be an exclusive governing body with sole authority to manage.

The approaches taken by the other “association” states are somewhat less satisfactory because the statutes merely call for “centralized management” and do not specify precisely how this is to

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68 Treas. Reg. § 301.7701-2(c) (1960).
69 UPA § 18(e).
71 UPA §§ 9(1), (4).
73 Alabama, Georgia, and Pennsylvania all seem to allow unlicensed members on their associations’ Boards of Governors. See supra the Chart. See note 167 infra and the accompanying text for a discussion of the ethical problem.
74 Treas. Reg. § 301.7701-2(g) (Examples 1, 5, 6) (1960).
75 Contra, Bickler, supra note 62, at 13-15; Comment, 75 Harv. L. Rev. 776, 780 (1962).
76 See supra the Chart for details.
be achieved. However, for tax purposes a "centralized management" can probably be attained by the use of an agreement which specifically provides for an exclusive governing body. Certainly at common law an association has "centralized management." Therefore, if both the applicable case law of a state and the professional association statute of that state recognize the right of an association to centralize exclusive control in a governing board, a professional association should be able to meet the requirements in the Regulations.

Attempts to incorporate the characteristic of "centralized management" into professional associations and professional corporations generate two problems which arise solely because of traditional concepts of professional practice.

The first problem is whether there can in fact be a sole vesting of authority in a central board in light of the notion that each practitioner has a personal right to advise, serve, and make binding agreements with his client or patient. The argument is made that if it is true that each practitioner can control the course of his relationship with a particular client, then it follows that a governing board does not have exclusive management authority.

This argument is questionable, because as a practical matter it is not true that each practitioner has plenary power to make binding contracts with a client. In many professional organizations today, for example, there are managing partners who can and do control the services which other practitioners extend to their respective clients. Because governing boards in professional associations and professional corporations are given statutory rights to manage all aspects of those organizations, they certainly will have at least the same control over their practitioner-employees as do managing partners today. In addition to control over the professional aspects of the organization, most states give the governing boards the exclusive right to manage all non-professional functions such as the hiring and firing of new employees and the setting of salaries. Therefore, in contrast to a partnership, with its rights of delectus personae, mutual agency, and joint control of all management func-

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75 See 1 Fletcher, Private Corporations § 21 (perm. ed. 1931); cf. Burk-Waggoner Oil Ass'n v. Hopkins, 269 U.S. 110 (1925); Tyrrell v. Commissioner, 91 F.2d 500, 501 (5th Cir.), cert. denied, 302 U.S. 747 (1937); Wholesalers Adjustment Co. v. Commissioner, 88 F.2d 116 (8th Cir. 1937).
76 See Bittker, supra note 62, at 11-14; Comment, 75 Harv. L. Rev. 776, 782 (1962) for an articulation of this idea.
77 The ABA Committee on Professional Ethics recognizes this right of managing partners to so control a firm of lawyers. See Opinion No. 303, 48 A.B.A.J. 159, 160 (1962).
tions by all partners, the professional association can in fact possess "centralized management" of a corporate nature.

The second problem concerns the existence of joint and several liability among practitioners in a professional organization for the unauthorized acts of other practitioners. Here the argument is made that there can be no effective "centralization of management" if one practitioner can subject all other practitioners in a firm or clinic to liability for his acts. In other words, it is asserted that each practitioner can effectively bind the entire firm by obliging every other practitioner and that under such circumstances the governing board does not have exclusive authority to make binding obligations.

It does not follow from this argument that the presence of joint and several liability will nullify the corporate characteristic of "centralized management." Under the Regulations "centralized management" exists when (1) the board has continuing exclusive authority to make independent decisions and (2) these decisions do not require ratification by any other member. Because in some states a governing board is given the exclusive power to make all management decisions, and because the feature of joint and several liability is by no means an affirmative right which empowers a practitioner to make management decisions, it is difficult to see just how joint and several liability detracts from a board's "exclusive" power to manage. The liability which results from a joint and several feature in no way impinges upon the authority of a board to manage. A governing board can certainly enforce its right to exclusive management by requiring indemnification from the errant practitioner for any of his acts which result in joint liability. As for the second element in the Regulations—i.e., that decisions of the Board must not require ratification by any other member—joint and several liability clearly is not a form of ratification by other members.

The Regulations supply the second reason that "centralized management" can coexist in the same organization with the feature of joint and several liability. In the first example of the Regulations, the governing board of a medical association is given exclusive managerial powers, and despite the fact that the members of the association remain jointly and severally liable for each other's acts, the association is considered to have "centralized management."

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7 See Wilson, supra note 21, at 13, 18.
8 Id. at 13.
11 Treas. Reg. § 301.7701-2(g) (Example 1) (1960).
3. Limited Liability

(1) An organization has the corporate characteristic of limited liability if under local law there is no member who is personally liable for the debts of or claims against the organization. Personal liability means that a creditor of an organization may seek personal satisfaction from a member of the organization to the extent that the assets of such organization are insufficient to satisfy the creditor’s claim.

a. Comments on the "Limited Liability" Requirement.—The criterion of “limited liability” is unattainable for a common law association which is classified as a partnership in a state which has enacted the UPA, since under that act partners are jointly and severally liable for certain claims against the partnership. Even more significant is the fact that “limited liability” is the one feature which distinguishes a common law association from a corporation, since an association has joint and several liability among its members.

It should be noted that this characteristic is not an essential feature of a corporation under the case law and under the Regulations. Both the court in the Kintner case and the Commissioner in the first and fifth examples recognize that organizations may be taxed as corporations without possessing any form of “limited liability.”

b. Comments on the New Statutes.—The requirement of “limited liability” has fostered a variety of responses from the states. However, in spite of this variety, very few, if any, of the statutes fulfill the requirements specified in the Regulations.

Several states have adopted a rather stock phrase which limits personal liability to the practitioner directly involved in a transaction with a client or patient. The difficulty with this phrase is the lack of clarity of the terms “personally participate” and “render.” In all probability these statutes retain personal liability for a practitioner for the acts of his agents and servants, for surely acts committed by an agent or servant constitute a form of direct participation by the principal. Thus, even in the five states where the business corpora-
tion laws govern in conjunction with the stock phrase—and no personal liability exists on the part of shareholders not directly involved in a transaction with a client—it is impossible to satisfy the Treasury requirement that no member of the organization be vicariously liable for claims against the organization. Therefore, there is no "limited liability" of a corporate nature.

The status of members of associations in several of the "association" states is subject to considerable doubt. These states have ambiguous provisions which state that "the Act does not modify any law applicable to the professional relationship including liability arising out of such service." It seems doubtful that this clause will in any way change the common law rule of joint and several liability among members of an association. The clause certainly does not change the practitioner's personal liability to his client for his acts or for those of his agents; therefore, for tax purposes, the criteria of "limited liability" remains unattainable for associations in those states.

The other states fail to satisfy the "limited liability" requirement for one of two reasons. When there is no provision concerning "limited liability" in an "association" state, the common law will prevail and there will be no limitation on the member's personal liabilities. Finally, some states expressly call for some form of joint and several liability.

4. Free Transferability of Interests

(1) An organization has the corporate characteristic of free transferability of interests if each of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in

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80 Arkansas, Florida, Minnesota, Oklahoma, and South Dakota have such provisions. See supra the Chart.
81 Clearly the business corporation laws will preclude shareholder liability unless, of course, the shareholder himself commits negligence or some other tort. However, the Ohio statute in particular does not seem to apply the business corporation laws to the liability aspects of the association. On the face of the statute the business corporation laws apply only to "organization and the manner of filing articles of incorporation." Ohio Rev. Code Ann. § 1785.08 (Page, Supp. 1961).
83 See Pa. Stat. Ann. tit. 14, § 197-17 (Supp. 1961); Service Corp. Law, Wisc. Stat. Ann. § 180.99(8) (Supp. 1961). The Connecticut (association) statute is particularly difficult to understand. The act straightforwardly grants "limited liability so that individual members of the association shall not be individually or severally liable for its debts...." However, the same sentence then rules out any limitation on "individual or several liability in the Articles of Association or otherwise, for any acts of reckless or wanton conduct, negligence, malpractice, professional misconduct or tort." Evidently there is several liability in any situation where the association incurs liability because of some tortious act, but there is not several liability for contract claims. See Conn. Gen. Stat. § 34-82 (Rev. of 1918, rev. to 1962).
the same organization a person who is not a member of the organization. In order for this power of substitution to exist in the corporate sense, the member must be able, without the consent of other members to confer upon his substitute all the attributes of his interest in the organization. . . .

a. Comments on the "Free Transferability" Requirement.—Clearly these requirements cannot be met by any organization which is treated as a partnership in a jurisdiction governed by the UPA. The reason is that assignments of interests in an organization governed by the UPA transfer only proprietary and not managerial rights. Moreover, under that Act the resignation of one of the partners from the partnership will cause a "dissolution" unless otherwise agreed.

The Regulations accept as a corporate characteristic a "free transferability" which is weakened to the extent of a right of "first refusal." Under this method, shares of stock may be freely transferred after the governing board has first been given an opportunity to purchase the shares at fair market value. However, even if the requirement of "free transferability" is completely abrogated, the Treasury has indicated that an organization may still obtain corporate tax treatment if it has satisfied the other three requirements.

b. Comments on the New Statutes.—All of the new laws, with the exception of the Texas statute, permit the transfer of interests in a professional corporation or professional association only to licensed members of the profession. However, this type of limitation appears to have been discounted by the Commissioner, because the association in Example 1 of the Regulations contains a similar restriction, yet "free transferability" is stated to be a positive corporate characteristic of the organization. In addition to this limitation on the transfer of shares, most states adopt the first refusal modification. Thus, under many statutes a transferor will have to offer any shares he is selling to the governing board, and if rejected by the board, then limit his prospective buyers to licensed persons.

The new statutes do not clearly state whether prospective pur-

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84 Treas. Reg. § 301.7701-2(e) (1960).
85 UPA § 27.
86 See UPA §§ 29, 41(1).
87 Treas. Reg. § 301.7701-2(e) (2) (1960).
88 Treas. Reg. § 301.7701-2(g) (Examples 1, 4, 5, 6) (1960). Examples 1, 4, 5, and 6 were approved for corporate taxation. For Treasury approval of an organization without capital stock, or any form of transferable memberships, see Letter from John S. Littleton, Director, Tax Rulings Div., Comm't of Int. Rev., to Reid & Riege, P-H Pens. & Prof. Sh. Rep. § 11979 (1961).
89 See supra the Chart.
90 Treas. Reg. § 301.7701-2(g) (Example 1) (1960).
chasers of membership interests must be currently engaged in active professional practice in order to acquire the interests. It is equally uncertain whether retiring practitioners are to be permitted to hold their interests. If the potential buyers are limited to those in active practice, or if retiring members cannot retain their interests or acquire other shares or certificates, then there is an even more substantial limitation placed on "free transferability."

When this additional restriction is added to the first refusal modification and the narrowing of the class of purchasers to licensed persons, it is evident that "free transferability" has become a "qualified transferability"; and as such, it seems doubtful that the characteristic is truly "corporate" in nature.

Without the limitation of sales to active practitioners, the transferability of interests in a professional organization appears to be more corporate in nature than non-corporate. In spite of all other limitations, a transferor can select his transferee from among licensed members of his profession, and he can transfer all vestiges of his interest to the person of his choice, unless the board chooses to buy his shares. Therefore, since the Treasury's only emphasis seems to be on assuring a form of transferability through which a shareholder may sell his interests without securing the consent of any other person, most of the new organizations do seem to be more corporate in nature in this respect.

Several states permit additional restrictions on transferability. However, these further impediments will, in all probability, eliminate any chance of meeting the requirements of the Regulations.

Because of the exclusionary nature of the Texas provision, the articles will control the transfer of membership interests. Since the common law governs the professional association, there appear to be no restrictions on "free transferability" except the limitations inherent in any professional organization, viz., transfers to licensed persons only.

5. Is Corporate Taxation Possible Under the Regulations?

Whether professional associations and professional corporations can qualify for corporate tax treatment is presently a matter of great debate. Because of the variety of legal factors which come into play under the different state statutes and under the particular articles to be considered, each organization will have to be treated separately by

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101 For an opinion that this feature deals a fatal blow to the transferability requirement, see Bittker, supra note 62, at 17.
103 Namely, Alabama, Florida, Georgia, and Pennsylvania. See supra the Chart.
104 See 1 Fletcher, supra note 71; McKay, supra note 41, at 436.
the Internal Revenue Service. Consequently, conclusions which are
general in nature are difficult to make. However, based upon the
considerations previously discussed, it appears that organizations in
a few states can possibly satisfy the tax requirements. In summary,
the criteria and the reasons why each may or may not be satisfied by
the state statutes may be stated as follows:

1. There can be “continuity of life” in organizations in states
where the enabling legislation explicitly confers this attribute upon
the professional association or the professional corporation. Under
these particular statutes, a professional organization possesses a “con-
tinuing identity which is detached from the relationship between its
stockholders.”

2. There can be “centralized management” under the statutes
which grant exclusive managerial authority to a central board. The
reason is that there is nothing inherent in the nature of professional
practice to prevent such explicitly conferred “centralization.”

3. There can be at least a modified form of “free transferability
of interests” which is more corporate than non-corporate in nature.
The restrictions which the states usually place on the “free transfer-
ability” are: (a) a limitation upon transfers to licensed persons only;
and (b) the first refusal technique, which permits the organization
to have some control over its membership. While these limitations do
severely narrow the group to whom transfers may be made, it is sig-
ificant that there is usually no requirement that the consent of other
members be obtained before any proposed transfer is made. Con-
sequently, for the most part, the Regulations are satisfied.

4. There cannot be a limitation on the personal liability of pro-
fessional shareholders which is more corporate than non-corporate in
nature. This conclusion is based upon the premise that in retaining
all of the traditional liabilities which attend the professional relation-
ship, the new statutes render the practitioner personally liable for his
own acts as well as those of his agents and servants.

C. Associations Or Corporations?

In spite of the eagerness exhibited by the states to gain preferential
tax treatment for professional groups, some have labeled their pro-
genies “professional associations” without any ostensible reason for
shunning the “corporation” name tag. However, in doing so, these
states have blurred to some extent the already hazy distinction be-
tween an ordinary association and an ordinary corporation. Of course, this blurring has not confused the states’ administrative authori-

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105 These are the words used in the Treasury Regulations at § 301.7701-2(b) (2) (1960).
ties, for at least Minnesota and Connecticut have ruled that their “associations” must pay state corporation taxes. The major difference between an association and a corporation is that an association has the feature of joint and several liability among its members. However, under the Georgia statute there is a positive declaration that members of the association are “not . . . individually liable for the debts of, or claims against, the . . . association unless such member . . . has personally participated.” Moreover, instead of the ordinary membership certificates, the Georgia “association” may issue stock which is “freely transferable” to licensed practitioners. In addition, the “association” has a highly centralized management, and individual members are denied the power to obligate or dissolve the “association.” Other characteristics which are corporate in nature include the power to contract, hold real property, sue and be sued, and make investments in its own name. As a rather conclusive reminder that the “professional association” is not a true association, the Georgia statute invokes the general corporation laws to cover all matters not touched upon in the special “professional association” statute. The only traditional distinction between a corporation and an association which Georgia retains is that of formal and informal formation and dissolution. For unlike an ordinary corporation, the “professional association” need not be incorporated by filing with the Secretary of State nor dissolved by a court order; rather, the articles are simply filed with the clerk of the local superior court and withdrawn in the same manner after a two-thirds vote favoring dissolution.

In a somewhat converse position is the professional service corporation of Wisconsin. That “corporation” retains the association feature of joint and several liability for tort claims against the

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106 The Connecticut ruling was reported in 1 P-H Corp. Serv. § 13.9 (1961). The Ohio ruling was handed down in Tax Bull. No. 161, Tax Commissioner 8-15-61, and reported in 1 P-H Corp. Serv. § 12.9 (1961). Note that the recent Virginia act provides that the professional association shall be taxed in Virginia as a corporation. Professional Ass’n Act § 25, 4 P-H Corp. Serv. Va. 374 (1962).


organization.\textsuperscript{118} However, for all other purposes the organization is more in the nature of a corporation because it is governed by the business corporation laws.\textsuperscript{119}

Undoubtedly the states have avoided the designation “corporation” in order to by-pass possible ethical objections to corporate practice of a profession. While this avoidance may have been wise for purposes of dodging local ethical problems, the states which have attached “corporation” to their professional organizations have procured a salutary tax consequence. Early in 1961 the Treasury ruled that it would accept a professional corporation prima facie as a tax corporation for the purpose of ruling on that organization’s qualified pension plan.\textsuperscript{120} In contrast, however, the professional associations must first prove their right to be taxed as a corporation and then attempt to qualify their pension plans.

D. The “Employee” Requirement

Since a motivating factor in the passage of the recent statutes was the desire to obtain more favorable pension and profit sharing opportunities, it is essential that an employer-employee relationship exist between the professional organization and all practitioners who desire to participate in such plans.\textsuperscript{121} Rulings of the Internal Revenue Service indicate that a professional person will be classified as an employee of a corporation only if he is an employee “for all purposes . . . .”\textsuperscript{122} which means he must be substantially under the control

\textsuperscript{118} Service Corp. Law, Wisc. Stat. Ann. § 180.99(8) (Supp. 1961). The Arizona professional corporation also retains the feature of joint and several liability, although it is not altogether clear to what claims such liability applies. Section 10-905 of the Arizona Professional Corporation Act states:

Nothing in this chapter shall be construed to alter any law applicable to the relationship between persons furnishing and receiving professional service, including but not limited to liability arising therefrom, and the shareholders of the corporation shall be and remain jointly and severally responsible for such liability. 2 P-H Corp. Serv. Ariz. 43 (1962).

As if this were not confusing enough, the legislature in § 10-908(5) made it mandatory that the professional corporation “provide that the private property of shareholders be exempt from liability for corporate debts except as set forth in section 10-905.” 2 P-H Corp. Serv. Ariz. 44 (1962). Presumably the legislature meant to make the same distinction between claims on torts and claims on contracts which the Wisconsin statute clearly makes.


\textsuperscript{122} Rev. Rul. 17-163, Part 2(i)(3), 1957-1 Cum. Bull. 128, 114. This ruling modified an earlier ruling which had emphasized the necessity of control over the potential employee. P.S. No. 15 (1944); P-H Pens. & Prof. Sh. Rep. § 12513 (1961). However, the current Treasury Regulations still require a relatively large amount of control. Regulation § 31.3401(c)-1(b) (1937) reads:
of the governing body and classified as an employee for such things as the Social Security program. Under "association" statutes like that of Pennsylvania, which gives the board of governors express powers to hire and discharge employees, to set all salaries, to make all management decisions, and to establish all distributions from profits, the requirements of the Revenue Rulings are easily met. However, under the statutes of Connecticut, Tennessee, and Texas, the employer-employee relationship will have to be firmly established in the articles or by individual contracts since the statutes themselves supply few guideposts for determining legal relationships within the associations.

(b) Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee. (Emphasis added.)

Section 31.3401 (c)-1 (c) continues:

Generally, physicians, lawyers, dentists, veterinarians, contractors, subcontractors . . . and others who follow an independent trade . . . or profession, in which they offer their services to the public, are not employees. The Regulations are on sound ground in stating that normally professional practitioners are not considered employees. Taking physicians and surgeons (including dentists), for example, it was long the rule that physicians were not regarded as agents of persons hiring them since they were not under that person's control in rendering the professional services. See Annot., 19 A.L.R. 1168, 1183 (1922). Since the Regulations appear to use "employee" in the sense of "agent," the Regulations merely restate the common law rule. However, some cases have recognized a physician as an "employee." See Tompkins v. Pacific Mut. Life Ins. Co., 53 W. Va. 479, 44 S.E. 439, 62 L.R.A. 489, 97 Am. St. Rep. 1006 (1903); cf. Woodburn v. StandardForgings Corp., 112 F.2d 271, 129 A.L.R. 337 (7th Cir. 1940).

116 The provisions of § 13 of the Virginia Professional Association Act are similar to the Pennsylvania act. See 4 P-H Corp. Serv. Va. 372 (1962). See also the favorable provisions in Alabama, Georgia, and South Carolina. For the Alabama and Georgia statutes see supra the Chart. For the South Carolina provisions see Professional Association Act, 4 P-H Corp. Serv. S.C. 55-18 (1962).
117 These three states add amendments to their respective Uniform Partnership Acts. The changes seem designed only to meet the four criteria specified in the Kintner Regulations. See supra the Chart.
118 Richard MacKay, the Texas attorney who drafted the articles of the Southwestern Medical Clinic (which was the clinic involved in the Galt decision), has set out a list
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E. Other Economic Considerations

Once a professional corporation has been approved for corporate tax treatment, aside from the benefits gained, there are certain undesirable tax consequences to be considered. Because several of these problems have been thoroughly discussed elsewhere, let it suffice here to list the possible adverse factors which any draftsman should consider: (1) double taxation on earnings of the corporation and dividends to the shareholders; (2) the personal holding company tax; (3) the accumulated earnings tax; (4) state corporation taxes for both professional associations and professional corporations; (5) taxes on distribution of assets on dissolution; (6) higher incorporation and certificate renewal fees; (7) possible costs of litigation which may be necessary to decipher some of the vague substantive law provisions in some of the statutes.

When the effects of these taxes are calculated, it may well be that a professional corporation is economically disadvantageous. Certainly these additional taxes, plus the contributions to a pension and profit sharing plan, will result in a substantial drop in a practitioner's take-home pay (especially when contrasted with his former rights to an immediate sharing in the profits of a partnership). Moreover, in

of suggestions for assuring that an employee status may be obtained in an association at 2 P-H Tax Ideas § 8017.2 (1961). He includes:

1) Payment of associates entirely by salary, with no right to participate in profits by drawing accounts.
2) No right on the part of the associates to any particular fee related to work he has done.
3) Define work and vacation schedules.
4) Obligation of the association to supply a place to work as well as the equipment.
5) The right of control over the work of the associates by the association.
6) Policy and management vested in elected representatives.
7) Power in the association to hire and discharge employees.
8) A management group smaller than the number of associates.

See Bittker, supra note 62, at 6 n.8 (on the personal holding company tax); Comment, 75 Harv. L. Rev. 776, 790 (1962) (on the accumulated earnings tax, personal holding company tax, and double taxation); Stavole, Corporate Employee Tax Status for the Professional Man, 11 Clev.-Mar. L. Rev. 176, 182-83 (1962) (on the accumulated earnings and personal holding company taxes).

\[133^{13}\] These fees are nominal in some states, e.g., Florida, and fairly substantial in others, e.g., Minnesota.

For example, under the many statutes which purport to limit personal liability to those practitioners who "personally participate" in rendering professional services, what type of act does it take for a person to "participate"? If an officer of a professional association of lawyers asks an associate to help another associate in briefing a case, has the officer "personally participated" to the extent that he will be held responsible for any claims from the client involved? What if a Board of Governors in a medical association makes an informal decision to take a certain course of action in regard to a patient; will each Board member have "personally participated" in that patient's case?
recent years in most states the case law construing the legal rights and liabilities of associations, their associates, and third parties, has "atrophied." The uncertainties about potential liabilities and responsibilities caused by this lack of substantive law are additional factors which should be carefully weighed. Thus it is possible that a professional association or professional corporation may be less profitable than a partnership because of the numerous taxes and less attractive because of the lack of substantive law.

III. LEGISLATIVE, LEGAL, AND ETHICAL OBJECTIONS TO PROFESSIONAL INCORPORATION

A. The Problems Encountered

Before the recent flurry of statutes, incorporation by professional men was generally considered undesirable. Not only were there legislative decrees as well as cases forbidding such practices, but the professions themselves took firm positions against incorporation by practitioners. Now, of course, the situation has greatly changed; and statutes permitting professional incorporation are in the vogue among the various state legislatures. However, it remains to be seen if all of the courts and the various professional societies in each state will endorse these new statutes. With that in mind, this section presents for analysis the four fundamental objections which in the past have been used to strike down attempts made by professional men to incorporate. The purpose of the section is to test the vitality of these objections in light of the recent enactments.

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136 See Bromberg, supra note 2, at 389 n.11.
137 However, see the article on page one of the May 23, 1962, edition of the Wall Street Journal in which officers of some of the newly-formed associations and corporations attest to the money saved.
139 See cases cited notes 143, 151, 161, and 178 infra.
140 E.g., State Bar of Texas, Canons of Ethics, Canon 32 (1958); ABA Canons of Professional Ethics and Judicial Ethics, Canons 34, 35 (Rev. of 1957); Texas Society of CPAs, Roster of Members, Rules of Professional Conduct Nos. 3, 11 (1956-57). The AMA had prior to this time opposed the corporate practice of medicine, though there seems to be no official canon or rule prohibiting such. See AMA Digest of Official Actions 1846-1918, at 129, 130, 134, and 142 (1959).
142 These four have been selected by the author as the most serious, rational arguments against professional incorporation. See generally 6 Fletcher, Private Corporations § 2524 (perm. ed. rev. repl. 1950); Lewis, Corporate Capacity to Practice Law—A Study in Legal Hocus Pocus, 2 Md. L. Rev. 342 (1938); Willcox, Hospitals and the Corporate Practice of Medicine, 43 Cornell L.Q. 432, 443 (1960) (three reasons); Comment, 45 Mich.
The form used in this section is similar to that employed in the preceding one. First, an objection is stated. Immediately following each is a presentation of the treatment accorded to it by the various states. Finally, there are comments upon the objection and upon its statutory treatment. Even though these legislative, judicial, and ethical expressions of disapproval have been applied mainly against corporations, both the “corporation” and the “association” statutes are classified below because of the similarities between the two.

1. Objection

Because a corporation is an artificial entity, it cannot possess the personal, moral, and intellectual qualifications required of a prospective practitioner under the licensing statutes.\(^{143}\)

a. Treatment Under the Statutes.—In the “corporation” states there has been no attempt made to license the corporation per se. However, five states do require an annual certification which is some-

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L. Rev. 885 (1947) (two “basic” reasons); Note, 48 Yale L.J. 346 (1939) (two “common” objections).

An objection, not analyzed below, which is sometimes mentioned is that of a fear of a loss of freedom by the client in selecting his practitioner. See People ex rel. State Bd. of Medical Examiners v. Pacific Health Corp., 12 Cal. 2d 156, 82 P.2d 429, 430 (1938); Note, 48 Yale L.J. 346 (1939).

Statements to the effect that “legislative intent” forbids incorporation, or that practice of a profession is not a “business purpose” under the general corporation laws, usually seem to be conclusions which are based on the four objections suggested. See In re Cooperative Law Co., 198 N.Y. 479, 92 N.E. 11, 31 L.R.A. 1229 (1910). However, where the regulatory statutes provide that only “natural” persons may practice a profession, this objection seems sound. See People ex rel. Kerner v. United Medical Serv., supra note 142 (only a natural person can practice medicine); People ex rel. Illinois State Bar Ass’n v. People’s Stock Yards State Bank, 344 Ill. 462, 176 N.E. 901 (1931) (emphasizing the personal aspect of the right to practice law); State v. Bailey Dental Co., 211 Iowa 781, 234 N.W. 260 (1931) (dentistry); McMurdo v. Getter, 298 Mass. 393, 10 N.E.2d 139, 142 (1937) (optometry); In re Cooperative Law Co., supra note 142 (law); People ex rel. Ludin v. Merchants’ Protective Corp., 105 Wash. 12, 177 Pac. 694 (1919). But see State ex rel. Sager v. Lewin, 128 Mo. App. 149, 106 S.W. 181 (1907); State Electro-Medical Inst. v. Platner, 74 Neb. 23, 103 N.W. 1079 (1905); State Electro-Medical Inst. v. State, 74 Neb. 44, 103 N.W. 1078 (1905). These latter three cases admit that a corporation cannot be licensed, but they deny that this is a bar to its offering professional services through licensed agents. Supporting this position are Lewis, supra note 142; Wilcox, supra note 142, at 435; Comment, 45 Mich. L. Rev. 885 (1947); Note, 48 Yale L.J. 346 (1939).

See discussion note 110 infra and accompanying text.

There is a split of authority as to whether the practice of optometry should be considered a “learned” profession. Some states say it is not like medicine and law, and, therefore, a corporation may offer such services through duly licensed employees. Compare Bennett v. Indiana State Bd. of Registration and Examination in Optometry, 211 Ind. 678, 7 N.E.2d 977, 981 (1937), and State ex rel. Beck v. Goldman Jewelry Co., 142 Kan. 861, 1 P.2d 995 (1935), with Silver v. Lansburgh & Bros., 111 F.2d 518, 519, 128 A.L.R. 582 (D.D.C. 1940); Jaeckle v. Bamberger & Co., 119 N.J. Eq. 126, 181 Atl. 181 (Ch. 1935); and State ex rel. McKitttrick v. Gate City Optical Co., 334 Mo. 427, 97 S.W.2d 89 (1936).
what similar to a licensing requirement.\textsuperscript{144} In addition, all of the "corporation" states require that all shareholders, agents, and employees be licensed.\textsuperscript{146}

None of the "association" states seek to license or even to certify the associations. However, all states except two require that all members (associates), agents, and employees be licensed.\textsuperscript{148} The other two states, Tennessee and Texas, have no relevant provisions.\textsuperscript{147}

b. Comments.—Most states do not consider this objection an important one, and clearly it has been ignored. The prevailing view seems to be that if all of the shareholders, agents, and employees are licensed, then the public is adequately protected.\textsuperscript{149} The reason for rejecting the argument that a corporation must be licensed like any practitioner is that an organization in and of itself poses no threat to public safety.\textsuperscript{149} It is felt that since the sole purpose of the licensing statutes is to give protection to the public from quacks and charlatans, this goal is achieved as long as the individual practitioners in an organization are required to be licensed. Hence, fear of harm to the public by an unlicensed corporate entity is unfounded in the face of the new statutes.\textsuperscript{149}

\textsuperscript{144} It should be noted that all numerical classifications in the text are based on the 1961 statutes. Provisions of the 1962 statutes are cited in the notes when those provisions are relevant.


\textsuperscript{148} See supra the Chart for the full text of the Texas provision; Tenn. UPA, Tenn. Code Ann. § 61-105(3) (Supp. 1961).

\textsuperscript{149} In re Florida Bar, 133 So. 2d 514, 516 (Fla. 1961).

\textsuperscript{150} See Lewis, supra note 142; Comment, 45 Mich. L. Rev. 885, 886 (1947); Note, 48 Yale L.J. 346 (1939).

\textsuperscript{144} This idea was apparently the rationale behind the Missouri and Nebraska cases, cited supra note 143, when they allowed a corporation to offer professional services to the public through licensed physicians. The courts did seem to get too wrapped up in technicalities, since they attempted to distinguish between the corporation's "practicing" medicine and the corporation's "offering" of professional medical services by way of contract. Actually this is a weak basis on which to decide the cases, for many other cases involving banks and trust companies and their attempts to "offer" professional services have reached the opposite result. E.g., Re Otterness, 181 Minn. 254, 232 N.W. 318, 73 A.L.R. 1319 (1930). Likewise, when insurance companies have sought to "offer" medical services to their insured, it has been held to be an illegal "practicing" of medicine. E.g., Pacific Employers Ins. Co. v. Carpenter, 10 Cal. App. 2d 592, 52 P.2d 992 (1935). Of course, there is one vital distinction—in the Missouri and Nebraska cases all of the owners, or substantially all of them, were the licensed practitioners who were offering the services. However, neither court based its decision on this distinction.

The objection concerning the inability of a corporation to meet the literal requirements
Clearly, the vital issues concerning the "oughts" or "ought nots" of professional corporations do not lie in this rather superficial area—in spite of the large number of courts which have struck down attempts at professional incorporation on this basis. Even assuming the existence of a reputable professional corporation having duly licensed shareholders, agents, and employees, there are still problems involving the legal and ethical effects a corporation will have on the manner in which these shareholders, agents, and employees offer professional services.

2. Objection

A corporation will destroy or seriously impair the high degree of trust and confidence which is necessary to the professional relationship, because the corporation will act as an intermediary between the practitioner and his client.151

a. Treatment Under the Statutes.—A majority of states answer this objection by almost identical provisions which specify that the traditional practitioner-client relationship shall remain unchanged.152 Aside from this provision, the statutes are silent with respect to the professional relationship except that they do differ widely in distribution of the risk of liability which may arise from that relationship.153

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151 The reasons are: (1) the client will have his contract with the corporation, not with the professional man; and (2) the professional man will owe a primary duty to the corporation, not to his client. See Silver v. Lumbard & Bros., 111 P.2d 318, 119, 128 A.L.R. 182 (D.D.C. 1940) (dictum); Parker v. Board of Dental Examiners, 216 Cal. 285, 14 P.2d 67 (1912); McMurdo v. Getter, 298 Mass. 393, 10 N.E.2d 139 (1937); People v. People's Trust Co., 180 App. Div. 494, 167 N.Y.S. 767 (1917); United States Title Guaranty Co. v. Brown, 86 Misc. 287, 149 N.Y.S. 186 (Sup. Ct. 1914), aff'd, 166 App. Div. 688, 132 N.Y.S. 470 (1917); People ex rel. Lundin v. Merchants' Protective Corp., 105 Wash. 12, 177 Pac. 694 (1919); 6 Fletcher, Private Corporations § 2124 (perm. ed. rev. repl. 1910); see also Batt v. Arizona State Dental Bd., 57 Ariz. 239, 112 P.2d 870 (1941) (stating that dentists are included in the phrase "physician and surgeon" as that phrase is used in defining the duties of the physician to his patients); cf. State Bar of Texas, Rules and Canons of Ethics, Canon 32 (1918); ABA Canons of Professional Ethics and Judicial Ethics, Canon 35 (Rev. of 1917); Texas Society of CPAs, Roster of Members, Rules of Professional Conduct Nos. 3, 5 (1956-57). But see Wilcox, supra note 142, at 446 (denying any division of loyalty in the case of non-profit corporations).

152 See supra the Chart for the provisions.

153 E.g., Professional Ass'n Act § 6, 2 P-H Corp. Serv. Ala. 222 (1961) (no liability unless the person "personally participated"); Professional Corp. Act §§ 10-905, -908, 2
b. Comments.—The recent statutes do not purport to change either the legal or the ethical responsibilities which accompany the professional relationship. In any given situation in which a practitioner is required to choose between protection of the corporation and protection of a client, the statutory provisions clearly imply that the practitioner owes a higher duty to the client. Thus, this facet of the professional relationship should be unaffected by the newly-created entities.

Since some of the statutes limit the liability of practitioners who do not “participate” in services to a client, or who do not themselves “furnish” services to a client, a more difficult question is whether the shield of limited liability which is cast over these practitioners will adversely affect the professional relationship. The answer to this question depends upon how broadly the courts interpret the words “participate” and “furnish.”

If the statutory terms are given relatively broad constructions, so that personal liability is placed upon a practitioner who renders even a nominal amount of assistance to a client, or to the practitioner who is handling the particular client, then the “professional responsibility” which each practitioner bears to each client or patient can be effectively supplemented by that threat of liability. However, if “participate” and “furnish” are narrowly construed, a practitioner may escape liability even though he may have advised the action taken in a particular situation. In such case, the client will have redress only against the practitioner with whom he happened to consult and an action against an asset-poor personal service corporation. Because of the likelihood that one individual case may receive the attention of several different practitioners in a firm or clinic, and because of the difficulty a client or patient may have in actually proving who is responsible for any wrong-doing, it may be best to impose joint and several liability on all practitioners in the profes-


E.g., Arkansas, Florida, Minnesota, Oklahoma, and South Dakota. See supra the Chart under the heading “limited liability” for these provisions. Of the 1962 enactments, Kentucky, South Carolina, and Virginia have similar provisions. See Professional Serv. Corp. Act § 6, 3 P-H Corp. Serv. Ky. 114 (1962); Professional Ass'n Act § 7, 4 P-H Corp. Serv. S.C. 16 (1962); Professional Ass'n Act § 14, 4 P-H Corp. Serv. Va. 372 (1962).


This is the term used in the recent opinion of the ABA Committee on Professional Ethics. See Opinion No. 303, 48 A.B.A.J. 139, 160 (1962).
Moreover, it should be noted that the professional associations and professional corporations actually do not have the need for limitations on the liability of their shareholders—-as do capital asset corporations—since there is less necessity for protecting investors in a professional organization. Thus, when these factors are considered in light of the fact that practitioners have always conducted their business under the aura of joint and several liability in their partnerships, it may well be that courts will refuse to permit even the form of “limited liability” offered by certain of the statutes.

3. Objection

There should not be a division of profits among nor exercise of control by laymen shareholders, because laymen would then be deriving benefits from professional acts without sharing in the attending professional responsibilities.

a. Treatment Under the Statutes.—All of the “corporation” states require each stockholder to be duly licensed. Four of these states do not permit an unlicensed officer or director to serve in the cor-

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158 Since it is doubtful if the prevailing form of “limited liability” is sufficiently corporate in nature to satisfy the Treasury Regulations, the imposition of joint and several liability should cause no additional adverse tax consequences.

159 The theory behind having “limited liability” in a corporation is to promote the investment of capital by offering capital investors personal protection from the liabilities incurred by the enterprise. See Ballantine, Corporations § 1 (1946); 1 Fletcher, Private Corporations § 14 (perm. ed. 1931). The medical and dental professions may have bona fide needs for capital to equip and staff their clinics and offices. Likewise, accountants and engineers may possibly need capital for particular types of services. However, the professional corporations are not designed to allow any real inflow of capital from outside sources since shareholding is restricted to licensed individuals. Hence, the only “investors” who might be protected by limited liability are other members of the profession.

160 This is not to say that there should be joint and several liability for creditors’ claims. A good example of this dichotomous type of liability is in the Wisconsin statute, which retains joint and several liability for clients’ claims, yet specifically rejects any personal liability for “debts or other contractual obligations of the corporation.” Service Corp. Law, Wisc. Stat. Ann. § 180.99(8) (Supp. 1961). Doubtless, this type of limited liability is insufficient for the Commissioner’s purposes.

161 E.g., People ex rel. State Bd. of Medical Examiners v. Pacific Health Corp., 12 Cal. 2d 156, 82 P.2d 429, 430 (1938); Parker v. Board of Dental Examiners, 216 Cal. 285, 14 P.2d 67 (1932); Pacific Employers Ins. Co. v. Carpenter, 10 Cal. App. 2d 592, 52 P.2d 99, 996 (1935); People ex rel. Kern v. United Medical Serv., 362 Ill. 442, 200 N.E. 117, 103 A.L.R. 1229 (1936); People ex rel. Chicago Bar Ass’n v. Chicago Motor Club, 362 Ill. 50, 199 N.E. 1 (1935); In re Cooperative Law Co., 198 N.Y. 479, 92 N.E. 15 (1910); cf. People v. Carroll, 274 Mich. 411, 264 N.W. 861, 863 (1936) (it is dangerous to separate the power of control from the source of knowledge); State Bar of Texas, Rules and Canons of Ethics, Canons 31, 32 (1958); ABA Canons of Professional Ethics and Judicial Ethics, Canons 34, 35 (Rev. of 1957); Texas Society of CPAs, Roster of Members, Rule of Professional Conduct No. 3 (1956-57); 6 Fletcher, op. cit. supra note 111. But see State ex rel. Sager v. Lewin, 128 Mo. App. 149, 106 S.W. 381 (1907).

poration. These same four also forbid any exercise of managerial power by an unlicensed person.\textsuperscript{163}

With the exception of Tennessee and Texas, all “association” states require that all members and associates be licensed.\textsuperscript{164} One state, Illinois, prohibits a layman from being on the governing board.\textsuperscript{165} However, four of the “association” states have no such prohibition,\textsuperscript{166} and the statutes of Georgia, Pennsylvania, and Alabama even permit laymen to be on the governing board or to serve as officers.\textsuperscript{167}

b. Comments.—The concern about unethical profit sharing is allayed by a majority of the new statutes. The enactments which require all employees, agents, stockholders, and members of the organizations to be duly licensed clearly remove most possibilities of laymen sharing in the profits from professional acts. There is, however, one exception. With respect to employee profit sharing plans to be set up within the organizations, the propriety of permitting participation by the unlicensed administrative assistants is very questionable. In the case of lawyers, in particular, the ABA Committee on Professional Ethics has recently ruled that such employee profit sharing plans will be deemed unethical.\textsuperscript{168} The Committee did say, however, that other forms of deferred compensation plans were acceptable for professional as well as non-professional employees.

In addition to the skepticism expressed about the employee profit sharing plans, there is a serious question about the propriety of provisions in the statutes of three “association” states which permit unlicensed persons to serve as officers on the governing boards. There appears to be little difference between allowing laymen to serve as officers of professional associations and allowing banks and trust companies, or insurance companies, to offer professional services by


\textsuperscript{166} Connecticut, Ohio, Tennessee, and Texas.


\textsuperscript{168} Opinion 303, 48 A.B.A.J. 159, 162 (1962).
licensed employees. In both situations laymen are ultimately sharing in profits of the association—as compensation for their services—without any personal or professional responsibility for the professional services rendered. Clearly, this violates the judicial and professional canons of ethics.

Perhaps more objectionable than the possibility of sharing profits with laymen is the possibility that laymen will control practitioners in some of the professional associations. As noted, Georgia, Alabama, and Pennsylvania permit unlicensed persons to be members of the board or to serve as officers of the association. While the Georgia statute does prohibit any lay employee's participation in the "practice" of the profession, it would appear that such a restriction is really too ambiguous to satisfy the basic objection. If such restrictions are applied technically, and the layman is only prohibited from participating in decisions which concern the manner in which a practitioner should offer professional services, then the layman is given broad discretionary powers which can be used in the formation of important policy decisions for the organization. When he may, in addition, hire and dismiss employees, the extent of the layman's control over practitioners is very substantial. In these situations, then, the fear of a corruption of professional objectives by the unlicensed may well be valid.

Before enactment of the professional incorporation statutes, one court indicated that even if all officers, directors, and shareholders were licensed, the corporation would still be against public policy. The reason stated was that shares in the corporation would descend to laymen on the death of a stockholder. However, most of the new statutes now preclude such a possibility by requiring that the professional organization repurchase its stock from a deceased member's estate, or, in the alternative, the statutes at least empower the organization to repurchase the stock.

One criticism which may be levied against a few of the new statutes is that they fail to go far enough in restricting transfers of stock. For example, some statutes do not even authorize a first re-

169 See the cases cited note 161 supra where such practices were disapproved.
170 See ABA Canons of Professional Ethics and Judicial Ethics, Canon 34 (Rev. of 1937); Id., Opinion 8.
171 See the statutes cited note 167 supra.
173 See People ex rel. Los Angeles Bar Ass'n v. California Protective Corp., 76 Cal. App. 354, 244 Pac. 1089, 1091 (1926).
fusal type of restriction.\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).} Without the power to incorporate such a provision, a firm or clinic could conceivably find itself with little control over prospective shareholders. Because of the nature of professional practice, it would seem desirable to allow current members of an organization to control selection of new associates, especially since a first refusal type restriction has no adverse tax consequences.\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).}

4. Objection

Because a corporation is a separate legal entity, it will not be amenable to disciplinary action by a profession or by the state boards for questionable conduct.\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).}

a. Treatment Under the Statutes.—Four “corporation” states permit the state board to review certain actions of the corporation and, if necessary, to suspend the certificate of registration.\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).} The same four states require annual renewal of these certificates. Florida and Wisconsin do not give the state boards any additional control over professional corporations, however, they do cite as grounds for dissolution of such an organization the failure to dismiss promptly any disqualified employee or shareholder.\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).} The Oklahoma statute requires a certificate of registration of a professional corporation but specifies no grounds upon which the state board can base any disciplinary action.\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).}

Of the “association” states only Pennsylvania gives the state board express authority to discipline the association itself.\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).} While Connecticut and Tennessee do provide that the association is to be governed by the state laws regulating that profession, they fail to specify

\footnote{See Tenn. UPA, Tenn. Code Ann. § 61-105 (3) (c) (Supp. 1962).}
which administrative bodies can enforce the pertinent laws.\textsuperscript{188} Georgia and Alabama require that an annual report listing current members be sent to the Secretary of State;\textsuperscript{188} in addition, under appropriate circumstances that officer may recommend forfeiture proceedings to the Attorney-General.\textsuperscript{188} Ohio merely calls for an annual report to the Secretary of State certifying that all employees are licensed;\textsuperscript{189} and the Illinois enactment just states that all practitioners shall remain under the jurisdiction of the state boards.\textsuperscript{187} Texas has no related provision.

b. Comments.—Apprehension caused by the prospect of loss of control over a professional organization by a profession or by state boards is somewhat unjustified. Because of the degree of power over individual practitioners presently held by the respective professions and the state boards, there is little likelihood that a corporation as an entity, or practitioners acting as individuals, can long engage in unethical practices. Certainly, operation within a corporate framework can be no excuse for unethical conduct by any individual. Should such conduct occur, however, the corporate entity is no impenetrable shield to recourse by a state board against that individual. Furthermore, the power exercised over individual practitioners by the state boards and by the professions furnishes an effective means of controlling the organizational entity since that organization cannot long exist if its practitioners are disqualified to practice. In addition, some states do require immediate removal of disqualified shareholders and employees, or the professional association or professional corporation forfeits its charter.\textsuperscript{188}

Procedurally it will be more advantageous to state boards and professional societies if they can deal tete à tete with the professional organizations, rather than having to discipline the organization by reprimanding its employees. In some situations, e.g., unethical advertising, it may be difficult to determine who in particular is responsible for the wrongful act; however, if the state board or professional society can impose sanctions against the organization itself, the problem will be solved.\textsuperscript{189}

\textsuperscript{188}\textsuperscript{189}E.g., Arkansas and South Dakota. See footnote 3 to the Chart supra.
\textsuperscript{188}\textsuperscript{189}See \textit{In re Florida Bar}, 133 So. 2d 554, 557-58 (Fla. 1961), where the Florida
B. Summary Of The Objections

Of the four legal and ethical objections discussed, only one presents a formidable obstacle to the establishment of professional associations and professional corporations. That objection concerns the possible adverse effects the feature of limited liability may have upon the practitioner-client relationship. The objection concerning an inability to license a corporate entity because that entity is not a natural person has been shown to be specious. The problem regarding the sharing of control or profits with laymen is resolved by permitting only licensed persons to own and manage the organizations, and by avoiding profit sharing plans with lay employees. Finally, the objection in regard to the lack of disciplinary control over a professional organization is not so serious that it cannot be removed by additional legislation or by energetic action on the part of the state boards and the professions in bringing that organization under their control.

IV. Conclusion

The problems presented by professional associations and professional corporations fall into two main categories: taxation and professional ethics. Tax problems mainly concern the establishment of proper internal legal relationships in order to qualify for corporate tax treatment, and also, the establishment of an employer-employee relationship in order to qualify for pension and profit sharing plans. Professional ethical problems consist of the necessity of avoiding sharing of profits or management with laymen and the necessity of maintaining individual and organizational responsiveness to each client, i.e., preserving the practitioner-client relationship.

Placing ethical and tax considerations aside momentarily, the necessity for or desirability of incorporation by practitioners will largely depend on the attitudes of each profession. For example, physicians have justifiable needs for capital for equipment and clinical space; whereas lawyers are not as pressed by this need. However, the present form of private collectivization and socialization may lead to undesirable consequences in the form of similar federal collectivization for physicians; whereas neither accountants nor lawyers are faced with this prospect. Since professional societies control
professional activities only within their respective states, attitudes on acceptance will naturally vary, causing increasing diversity in treatment and tax consequences throughout the country.

Even assuming approval by local professional societies, resolution of all ethical problems, and satisfaction of the corporate tax requirements, professional men still face obstacles which may well make the corporation or association less desirable. A large array of possible taxes face the organization, e.g., federal corporate taxes, state corporate taxes, accumulated earnings taxes, personal holding company taxes, and taxes on distributions on dissolution. Moreover, the officers and dominant shareholders may find themselves saddled with a much more formal type of organization than they really desire, especially in a small organization, and ironically enough, a deficiency in substantive state law governing an organization's internal operations. Finally, if most states follow the Florida example and take the new organizations under the jurisdiction of their state boards, there may be additional regulations and formalities for the practitioners to observe.

Cause for the new incorporation laws has been traced to the current tax structure. The responsibility for the unfair treatment accorded self-employed persons and for the diversity in tax consequences now existing likewise may be laid at the doorstep of our fiscal policymakers. Possibly an adequate Keogh-type enactment would remove the discriminations and the accompanying need for professional corporations. However, accepting the status quo, professional men in some states may now be able to piece together a method of obtaining tax equality, though there are enough blank spots in the legal pattern to flag "caution" to even the enthusiastic.