

Professional Associations and Federal Income Taxation: Some Questions and Comments

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IN the years 1942–1948, the community property system was adopted by state legislatures in Oregon, Nebraska, Michigan, and Pennsylvania and was a candidate for adoption in New York and several other eastern states. Community property moved eastward in those days as irresistably as Rocky Mountain spotted fever, not because the League of Women Voters wanted it or even because it was the rediscovered heritage of Anglo-American law of which the British had been brutally deprived by the Norman Conquest, as a great scholar urged in his brief in *Fernandez v. Wiener*.¹ Not at all. The appeal of community property to states that had never enjoyed the civilizing mission of a Spanish occupation emanated, simply and solely, from the fact that it permitted husband and wife to split their income in computing their federal income tax. As the community property system spread, pressure mounted to throw open the privilege of income-splitting to all married couples regardless of their state's system of property law. As soon as Congress responded by enacting the joint return provisions of the Revenue Act of 1948, however, the "new" community property states lost their taste for Spanish law and repealed their statutes.

In the spring of 1961 a number of state legislatures enacted laws permitting physicians and other professional persons to organize "professional associations" or "professional corporations" for the practice of their professions.² If classified as "corporations" for

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¹ Brief for Attorneys General as Amici Curiae, *Fernandez v. Wiener*, 326 U.S. 340 (1945). Although signed by the attorneys general of eight states, the brief is heavily stamped by the scholarship of Max Radin who, with Joseph D. Brady and Walter L. Nossaman, was "of counsel."

² I have not been able to examine official prints of most of the laws, and have relied largely upon copies supplied to me by the courtesy of John P. Courts, of Prentice-Hall, Inc. Statutes have been enacted in the following states: Arkansas (Acts of 1961, Act 471, 2 P-H

federal income tax purposes, these organizations will permit physicians, attorneys, and other professionals to enjoy the federal income tax advantages of qualified pension and profit-sharing plans and other devices open only to "employees" and, if personal holding company status can be avoided, to shift part of their income from the "top" of their personal returns to the "bottom" of their corporate returns. In their abandonment of traditional prohibitions on the corporate practice of medicine, law, and other professions,³ the state legislatures displayed such haste and insouciance in response to no announced need except the reduction of federal income taxation,⁴ that some observers have been reminded of the 1942-1948 community property syndrome. Will the Treasury again feel that it must

CORP. SERV. *Ark.* 223 (1961) (Dental Corporations); Acts of 1961, Act 179, 2 P-H CORP. SERV. *Ark.* 224-A (1961) (Medical Corporations)); Connecticut (Acts of 1961, P.A. 159, 2 P-H CORP. SERV. *Conn.* 208 (1961)); Florida (Fla. Laws 1961, H.B. 2161, 2 P-H CORP. SERV. *Fla.* 229 (1961)); Georgia (Ga. Acts 1961, Act 285, 2 P-H CORP. SERV. *Ga.* 115 (1961)); Illinois (Ill. Laws 1961, S.B. 804, 2 P-H CORP. SERV. *Ill.* 225 (1961)); Minnesota (Minn. Laws 1961, ch. I (Extra Sess.), 3 P-H CORP. SERV. *Minn.* 555 (1961)); Ohio (Ohio Laws 1961, S. 550, 4 P-H CORP. SERV. *Ohio* 441 (1961)); Oklahoma (Okla. Laws 1961, S. 399, 4 P-H CORP. SERV. *Okla.* 54.67 (1961)); Pennsylvania (Pa. Laws 1961, A. 410, 4 P-H CORP. SERV. *Pa.* 327 (1961)); South Dakota (S.D. Laws 1961, ch. 29, 4 P-H CORP. SERV. *S.D.* 87 (1961)); Tennessee (Acts of 1961, ch. 181, 4 P-H CORP. SERV. *Tenn.* 109 (1961)); Texas (Acts of 1961, S.B. 119, 4 P-H CORP. SERV. *Texas* 424 (1961)); Wisconsin (Wis. Laws 1961, ch. 350, 4 P-H CORP. SERV. *Wis.* 339 (1961)). At this writing a bill is awaiting gubernatorial action in Alabama. Bills were introduced but not enacted in California, Iowa, New York, North Carolina, Oregon, Rhode Island, and Vermont.

I have excluded from the discussion that follows certain pre-1961 statutes of a specialized character, such as the Connecticut law authorizing the creation of Medical Group Clinic Corporations. *CONN. GEN. STAT. REV.* § 33-180 (Supp. 1959). This statute, prior to its amendment by Public Law 394 of 1961, evoked a favorable unpublished ruling. P-H CURRENT DEC. ¶ 54,753 (1961). The full texts of these statutes unavailable when this article was prepared.

³ The sources of these prohibitions on corporate practice of medicine, law, and other professions vary from state to state and are obscure in some. As to medicine, *see generally* Willcox, *Hospitals and the Corporate Practice of Medicine*, 45 CORNELL L.Q. 432, 435-449 (1960). As to law, *see generally* DRINKER, *LEGAL ETHICS* 159-169 (1953); *Opinion 283*, *OPINIONS OF ABA COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES* (1957). For these and other professions, *see* 1 FLETCHER, *PRIVATE CORPORATIONS* § 97 (1931). Although the content of the term "corporate practice" of a profession is uncertain, especially where professional services are provided only to employees of a common employer or are otherwise peripheral to the corporation's main activities, we are here concerned with professional groups whose sole function is to render professional services to the public.

⁴ Section 21 of the Oklahoma statute makes this alarming pronouncement: "It being immediately necessary for the preservation of the public peace, health and safety, an emergency is hereby declared to exist, by reason whereof this act shall take effect and be in full force from and after its passage and approval." This declaration presumably satisfies art. 5, § 58, of the Oklahoma Constitution, providing that legislative action shall not take effect until 90 days after the adjournment of the session, unless an emergency is declared by a vote of two-thirds of the membership of each house. As to federal tax reduction, evidently Oklahoma's state motto is "The Sooner, the better."

either bow to the state innovations or accept federal legislation that it may find no less distasteful?

The thesis of this article is that history has not repeated itself. In my opinion, the professional associations and corporations authorized by the 1961 wave of state legislation should not be classified as "corporations" for federal income tax purposes, at least not before a good many ambiguities in their status under state law have been resolved.

Five of the statutes (Connecticut, Georgia, Illinois, Ohio, and Pennsylvania) authorize professional practitioners to organize "associations" or "professional associations" for the practice of their profession; these laws eschew the label "corporation," and Georgia explicitly states that the group is "unincorporated." Although some of the provisions of the state corporation laws are made applicable to these groups, they also bear some earmarks of unincorporated groups, and their status under the Internal Revenue Code depends upon whether they are "associations" within the meaning of section 7701(a)(3). The "professional corporation" laws (Arkansas, Florida, Minnesota, Oklahoma, South Dakota, Tennessee, and Wisconsin) employ the term "corporation," sometimes amplified to "professional corporation," just as sedulously as the "association" statutes avoid it. Without drawing directly on the law of unincorporated associations, however, they impose restrictions on the professional corporation that are not applicable to typical business corporations.⁵ As will be seen, the two types of statutes⁶ are not sufficiently different, in my opinion, to warrant different classification in applying the federal income tax.

⁵ I do not mean to imply, here or later, that the term "corporation" has an immutable single reference. State law customarily includes a general business corporation law, and then goes on to provide other rules to govern some aspects of the creation, operation, and liquidation of specialized corporations: membership corporations, financial institutions, railroad, and utility companies, etc. In a sense, therefore, there is no such creature as "the" corporation. All of the groups just named, and others as well, may employ the label "corporation" without engaging in misappropriation or usurpation. Moreover, when Congress referred to "corporations" in the Internal Revenue Code, it intended to embrace a variety of groups with varying characteristics. But having said this, primarily to avoid a charge of conceptualism in using the term "corporation," I am proceeding on the theory that in applying the Internal Revenue Code, we must classify novel or borderline business groups in the manner employed in *Morrissey v. Comm'r*, 296 U.S. 344 (1935), viz., by comparing the characteristics of the group under examination with the characteristics of "typical" or "ordinary" corporations. A business group is not necessarily a "corporation" merely because every one of its characteristics may be found, if we go far enough afield and draw upon enough instances, in some other group that is indisputably a corporation. Since we must exercise judgment in generalizing from specific instances, this type of taxonomy is not an exact science.

⁶ The Texas provision, part of the curiously denominated "Texas Uniform Partnership Act," is characteristically *sui generis*. We are told by section 6(3):

In addition to these differences in the state laws, there are other differences of a more substantial character. Some states permit only medicine to be practiced in group form; others extend the privilege to a long list of professions or to any profession requiring a license. Some states permit an individual practitioner to take advantage of the legislation; others require at least two or three to make the election. There are other substantive differences among these laws, to some of which I shall refer hereafter.

In my discussion, I shall assume that the statutes are valid under state law, although the authority of the courts over the practice of law may cast a shadow in some states upon the validity of legislative action in this area,⁷ and there may be problems of a constitutional, ethical, or other nature in other professions as well. I shall also assume that state licensing agencies, whose power to regulate professional practice by persons under their aegis is explicitly or implicitly preserved by all the statutes, will impose no restrictions upon the new-born professional associations or corporations which would weaken whatever claim to be taxed as corporations they may derive from the naked language of the statutes. Should the Oklahoma Board of Optometry, for example, exercise its power under Title 59, section 585, of the Oklahoma statutes to provide that a professional corporation will lose its franchise if one of its shareholders becomes a habitual drunkard or succumbs to a contagious disease, I should suppose that optometry corporations in that state would not enjoy the kind of "continuity of life" that is possessed by ordinary business corporations.

Moreover, I shall also set aside the possibility that professional associations and corporations wishing to practice law, accountancy,

"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, filed in accordance with law, 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.

"This Subsection shall not be construed to change in any way the law applicable to associations which are not partnerships under this Act." Texas Acts 1961, S.B. 119, 4 P-H CORP. SERV. Texas 424 (1961).

I exercise an author's prerogative of exempting this statute, the legal effect of which escapes me, from my remarks.

⁷ See *In re Opinion of the Justices*, 289 Mass. 607, 194 N.E. 313 (1935).

The Supreme Court of Florida has authorized Florida lawyers to organize under the Florida Professional Service Corporation Act. In the Matter of The Florida Bar, 30 U.S. L.WEEK 2217 (1961).

or other professions before federal agencies may be required to relinquish some of the privileges accorded to them by state law, resulting in an adverse impact on their federal tax status. Finally, my discussion will be confined to the question whether professional associations and corporations qualify as "corporations" within the meaning of section 7701(a)(3) of the Code, excluding other tax hurdles that they may encounter in achieving some of their intended purposes even if they succeed in attaining corporate status.⁸

⁸ Even if these organizations are classified as "corporations," some of the federal tax results for which their members or shareholders yearn may elude them. At least four hurdles remain to be surmounted:

1. *Assignment of income doctrine.* If the arrangement between the shareholders and their corporation is an "assignment of earned income," within the vague contours of cases like *Lucas v. Earl*, 281 U.S. 111 (1930), it will not be recognized for federal income tax purposes. In appropriate cases, this doctrine would permit the fees and other professional income to be attributed to the persons whose personal services created the income rather than to the association or corporation. Some of the income might be appropriately allocated to the corporation, as compensation for the use of equipment, etc. owned by it, but in most professional firms, virtually all of the income is attributable to services rather than to capital. The Government's case for a reallocation would be strongest if the professional corporation were owned by a single person. Associations and corporations with two or more shareholders would be less vulnerable, since an arm's-length pooling of income does not ordinarily invoke the no-assignment-of-earned-income doctrine.

2. *"Sham" transaction theory.* In *Comm'r v. Laughton*, 113 F.2d 103 (9th Cir. 1940), the Government attacked the validity of a corporation that employed its sole shareholder (Charles Laughton) under an exclusive contract at a salary very much less than the company received for "loaning" him to motion picture producers. The Court framed the issue as "whether Laughton's hiring of himself to . . . [the corporation] for a salary substantially less than the compensation for which the corporation supplied his services as its employee to various motion picture producers, constituted, in effect, a single transaction by Laughton in which he received indirectly the larger sum paid by the producers," and remanded the case to the Board of Tax Appeals for further findings. *Id.* at 104. The result on remand is not reported. The Court's opinion speaks interchangeably of "a single transaction" and "a sham transaction." Since the *Laughton* case, the Government has relied on the personal holding company tax to reach such arrangements, but the *Laughton* case remains a potent weapon which the Government might turn against professional corporations, especially those with only a single shareholder.

Both *Laughton* and *Lucas v. Earl* may seem especially pertinent if the practitioner engages in practice simultaneously as an individual and in corporate form. See *Mayes v. United States*, 207 F.2d 326 (10th Cir. 1953), and *W. B. Mayes, Jr.*, 21 T.C. 286 (1953). Many attorneys may find parallel offices unavoidable, since they will probably continue to be named personally to executorships, trusteeships, guardianships, and other judicially supervised posts.

I need hardly suggest the relevance of section 269 and of such cases as *Gregory v. Helvering*, 293 U.S. 465 (1935), *Paymer v. Comm'r*, 150 F.2d 334 (2d Cir. 1945), and *National Investors Corp. v. Hoey*, 144 F.2d 466 (2d Cir. 1944), to professional associations and corporations organized solely to lay a foundation for federal tax benefits. The fact that Rev. Rul. 56-23, 1956-1 CUM. BULL. 598, ruling that a group of doctors who adopt the form of an association in order to establish a qualified pension or profit-sharing plan must be treated as a partnership, was revoked by Rev. Rul. 57-546, 1957-2 CUM. BULL. 886, does not preclude a revival of this theory.

3. *Professional persons as "independent contractors."* In the case of *United States v.*

"PROFESSIONAL ASSOCIATION" STATUTES

Turning first to the statutes authorizing the creation of "professional associations," I should like to base my discussion on the Georgia Professional Association Act,⁹ which for convenience is set out in full at the end of this article.

Under the Georgia Act, two or more persons licensed to practice a profession under the laws of Georgia, including attorneys, certified public accountants, physicians, and dentists, may form a professional association ("as distinguished from a partnership" according to section 2(b) of the Act) to carry on their profession by executing and filing Articles of Association. The association may have shareholders ("stock-type association") or members ("non-stock association"). In either event, their interests are described as freely transferable, except as restricted by the Articles. Members or shareholders must be duly licensed to render the professional service for which the association is organized, except that the estate of a deceased member or shareholder may retain his interest for a reasonable period of administration, but without participating in decisions concerning the rendering of professional service, and a share or membership may be sold or otherwise transferred only to another

Kintner, 216 F.2d 418 (9th Cir. 1954), physicians were held to be "employees" so as to be entitled to participate in a qualified pension plan. It is possible, however, that the "professional relationship" provision of the professional association and corporation laws will be interpreted to mean that the physician or other professional is an independent contractor rather than an employee, and hence not qualified for participation in a pension or profit-sharing plan. This would not alter the character of the association or corporation itself, but it would destroy the principal attraction that corporate status possesses for the professional man. See Rev. Rul. 61-178, 1961 INT. REV. BULL. No. 41, at 8, holding that a physician was an "employee" of a business corporation rather than an independent contractor for social security and withholding tax purposes; one of the elements establishing the status of employee was that he was subject to supervision "as to the manner in which his services are to be performed."

4. *Personal holding company tax.* The income of some—perhaps most—professional associations and corporations would probably be "personal holding company income" by virtue of section 543(a)(5) (1954), and the stock ownership requirement of section 542(a)(2) (1954) is also likely to be satisfied by most such groups. If the professional association or corporation is a personal holding company, it cannot be used to split income between the practitioner and his corporation, since the virtually confiscatory rate of the personal holding company tax would penalize any accumulation of income in the corporate treasury. Use of the corporation for the purpose of creating a pension plan would not be precluded, however, since the personal holding company tax is computed only after business expenses have been deducted. A personal holding company tax on the residue could ordinarily be avoided by distributing the corporation's income in the form of salaries and dividends or by making an election under Subchapter S.

⁹ Ga. Acts 1961, Act 285, 2 P-H CORP. SERV. Ga. 115 (1961). See APPENDIX, pp. 36-40 *infra*.

duly licensed person. The association may render professional services only through persons who are themselves duly licensed, and the laws applicable to the relationship between the professional and his patient or client are not modified. Subject to this preservation of the professional relationship, a member or shareholder of the association is not personally liable for the association's debts unless he personally participated in the transaction out of which the debt arose.

The association shall be governed by a Board of Governors elected by the members or shareholders, "so that centralization of management will be assured," and a person shall not have the power to bind the association merely by virtue of his being a member or shareholder. The association "shall continue as a separate entity independent of its members or shareholders for all purposes" for the time provided in its Articles or until dissolved by a vote of two-thirds of its members, notwithstanding the death, withdrawal, or expulsion of a member, the transfer of membership or share ownership, the admission of new members, or any other event that would work the dissolution of a partnership under Georgia law.

If a member, shareholder, agent, or employee of a professional association becomes legally disqualified to practice his profession, he must sever his financial interest in, or employment with, the association. An association that violates this requirement may be dissolved. If the Articles fail to fix the price at which the association or its members or shareholders may purchase the interest of a deceased, retired, expelled, or disqualified member or shareholder, the price shall be book value as determined by an independent certified public accountant.

An association may contract, hold and transfer real property, and sue and be sued in the firm name, and its assets are not liable to attachment for the individual debts of its members or shareholders. Finally, the association shall be governed "by all laws governing or applicable to corporations, where applicable" if not in conflict with the provisions of the Georgia Professional Association Act, and "no such association shall be held or deemed to be a partnership nor shall such association be governed by laws relating to partnerships."

The federal income tax status of the Georgia Professional Association depends upon whether it is an "association" within the meaning of section 7701(a)(3) of the Internal Revenue Code. In commenting on this question, I shall accept the Regulations recently issued under section 7701(a)(3) as a valid interpretation of the stat-

ute.¹⁰ We may appropriately and conveniently commence with the statement in the Regulations:¹¹

... since associates and an objective to carry on business and divide the gains therefrom are generally common to both corporations and partnerships, the determination of whether an organization which has such characteristics is to be treated for tax purposes as a partnership or as an association [and, hence, as a corporation] depends on whether there exists centralization of management, continuity of life, free transferability of interests, and limited liability.

Let us then examine the Georgia Professional Association to see if it possesses these four corporate characteristics.¹²

A. LIMITED LIABILITY

Section 7 of the Georgia Professional Association Act has the following to say about the personal liability of members and shareholders of a professional association:

This Act does not modify any law applicable to the relationship between a person furnishing professional service and a person receiving such service, including liability arising out of such professional service, and including the confidential relationship between the person rendering the professional service and the person receiving such professional service, if any, and all confiden-

¹⁰ See generally Lyons, *Comments on the New Regulations on Associations*, 16 TAX L. REV. 441 (1961). Efforts to establish that the new Regulations are erroneous in employing local law, as in Ray, *Corporate Tax Treatment of Medical Clinics Organized as Associations*, 39 TAXES 73 (1961), seem to me quite unsuccessful. When the old Regulations said that "local law is of no importance," what was obviously meant was that local law did not determine the organization's classification, and the new Regulations are in accord. But in determining whether the organization enjoyed continuity of life, centralized management, etc., the old Regulations looked to local law, as the new Regulations do. The simple fact is that there is no other place to find the organization's legal characteristics, as distinguished from its proper classification for federal income tax purposes.

¹¹ Reg. Sec. 301.7701-2(a)(2) (1960).

¹² The Regulations state that in addition to the six "major characteristics" listed in the above extract, "other factors may be found in some cases which may be significant in classifying an organization as an association, a partnership, or a trust" (Reg. Sec. 301.7701-2(a)(1) (1960)), but no other such "factors" are identified. I shall refer in the text to at least three characteristics of professional associations and corporations that probably belong in this category of other "factors"; all, to my mind, are earmarks of non-corporate status. They are: (1) the fact that members or shareholders must possess certain personal characteristics (they must be qualified to practice the profession; they evidently must not be felons; and in some instances they may not hold certain public offices or own shares in other professional corporations); (2) the fact that the vicissitudes of personal life (disqualification to practice, retirement, death, perhaps bankruptcy or conviction of a felony) may impose on the shareholder a duty to dispose of his interest; and (3) the fact that some professional associations (see note 41 *infra*) are evidently not required to have any capital, to treat their capital or earnings as a "trust fund" for creditors, or to meet any financial standards in the distribution of assets or the repurchase of shares. See notes 27, 28, 29, and 31 *infra*.

tial relationships previously enjoyed under the laws of this State or hereinafter enacted shall remain inviolate. Subject to the foregoing provisions of this Section, the members or shareholders of any professional association organized pursuant to the provisions of this Act shall not be individually liable for the debts of, or claims against, the professional association unless such member or shareholder has personally participated in the transaction for which the debt or claim is made or out of which it arises.

The more general language of section 18 should also be noted, although section 7 probably preempts the subject of personal liability and leaves little, if any, room for the operation of section 18 in this area:

Such professional association organized pursuant to the provisions of this Act shall be governed generally by all laws governing or applicable to corporations, where applicable, and not in conflict herewith, and no such association shall be held or deemed to be a partnership nor shall such association be governed by laws relating to partnerships.

Returning to section 7, we may profitably examine the first sentence at some length. Not only is it found, with minor variations, in most of the professional association and professional corporation statutes, but its inclusion in these statutes was probably essential to their quick and painless enactment. I do not think it is fanciful to envision the following dialogue between legislator and lobbyist in all of these states:

Q. What is the purpose of this bill?

A. It will enable doctors, lawyers, and others to get certain federal income tax advantages now unfairly denied to them.

Q. But will these laws affect the patient or client?

A. Absolutely not.

Q. How can I be sure of that?

A. Look at Section (insert appropriate number).

If section 7 of the Georgia Act and its counterpart in other states did no more than prevent the professional's personal liability for his own negligence in rendering services to a patient or client from being reduced or eliminated by the intervention of a professional association or corporation, it would be of little consequence to professionals or laymen. This is because the employee of a corporation is liable for his own negligence, notwithstanding the concurrent liability of his employer under the doctrine of *respondeat superior*, and a professional employee of a professional association or corporation would be subject to this rule even in the absence of a provision like section 7 of the Georgia Act. It seems more consonant with the purpose of the Georgia Act, and with its language as well, however, to

construe section 7 as preserving intact the entire congeries of relationships between an individual practitioner and his patients or clients.¹³ In the case of a physician, for example, this would include liability for the torts or other misconduct of the nurses, laboratory assistants, and other technicians who work under his direction or supervision, even though in the case of an ordinary business corporation an employee is not responsible for the misconduct of fellow employees unless it results from his own misconduct.

In preserving the professional relationship,¹⁴ the scope of the first sentence of section 7 is not restricted to tort liability. The private practitioner also has a contractual liability to his patient or client, and recent cases have seen an expansion of liability in this area, especially in suits against physicians for failure to effect a promised cure.¹⁵ In the case of an ordinary business corporation, employees are not liable for breach of a contract made in the employer's name; they act as agents, not as principals. I know of no exception to this rule for professionals employed by a corporation. When a physician in the medical department of a business corporation treats an injured workman, I should not suppose that he is liable for breach of contract if the patient fails to get the relief implicitly or explicitly promised to him. A member or shareholder of a Georgia professional association, however, is liable to patients in both contract and tort, if I read the first sentence of section 7 correctly, in precisely the same fashion as though he were practicing privately.

Do I stretch the first sentence of section 7 unduly by the further suggestion that it saddles a professional association with the mutual agency, resulting in mutual liability, that exists among the members of a professional partnership? Suppose the partners of the law firm of Smith, Jones and Brown reconstitute themselves as the Smith, Jones & Brown Professional Association under the Georgia Act. If the association renders an opinion, would only the member who wrote it be personally responsible? Or would personal liability also be imposed on those of his fellow members whom he consulted in

¹³ Since the attorney-client and other professional privileges are surely to be preserved by the Georgia Act, it seems to me incontrovertible that the term "any law" in section 7 includes common law rules of liability and rules of evidence, not merely statutes.

¹⁴ Here and elsewhere I have used the term "professional relationship" as a label for the first sentence of section 7 of the Georgia Act, although it refers to "the" relationship between the person furnishing professional service and the person receiving such service, including liability "arising out of" the professional service. If a patient slips on a rug in a physician's reception room, he may be personally liable under section 7; and even more remote events may be part of "the" relationship between the physician and his patient or be held to "arise out of" the professional service.

¹⁵ Miller, *The Contractual Liability of Physicians and Surgeons*, 1953 WASH. U.L.Q. 413.

preparing the opinion; on those who appear in the firm name; on those whose reputations led or may have led the client to come to the firm? Or are all members of the association personally liable on the ground that, being associated in the practice of law, each one is "a person furnishing professional service" within the meaning of section 7 to any client of the firm?

If a client's funds are mishandled, does the Georgia Act contemplate that he may look only to the association and to the member or shareholder who engaged in the wrongdoing? Lawyers have recently been exhorted to establish Clients' Security Funds on the ground that "we are responsible one for another and all of us for each of us."¹⁶ Whether this is true or not, a limitation of the phrase "person furnishing professional service" as used in section 7 of the Georgia Act and in similar statutes to the precise members of an association who personally participated in the transaction out of which the liability arose is one of those legal consequences I should have to see in a judicial opinion to believe. This is not to say that the state legislatures might not at some time choose to permit professionals to substitute corporate for personal responsibility, but it should not be lightly assumed that this change has been consummated by a statute that explicitly provides that the relationship between the person rendering professional services and the person receiving the services is not altered.

Section 7 of the Georgia Act does not define the phrase "person receiving such [professional] service." This term could be interpreted in the narrow sense of patient or client, but it might also be interpreted to embrace any person who relies on or is guided by the professional service in question, *e.g.*, the purchaser of business assets who relies on the legal opinion of the seller's attorney or on financial statements certified by the seller's accountant. Willing as the state legislatures may have been to assist accountants and attorneys to reduce their federal income tax burden, I doubt that they intended to take the radical step of undermining the confidence which members of the business community have come to feel they may properly place in opinions and certificates of this kind. For this reason, the phrase "person receiving such service" in section 7 should probably be interpreted to include any person who would have been entitled, in the absence of a professional association, to hold the professional who rendered the service liable for a misstatement, omission, or other defect.

In preserving the professional relationship, what is the impact of

¹⁶ Smith, *A Debt of Honor*, 47 A.B.A.J. 791 (1961).

section 7 on books and records arising from the rendition of professional services? In the absence of an association, such documents belong to the professional. If an association is interposed between a physician and his patient, however, do the documents belong to the association, or does section 7 have the effect of vesting ownership in the physician? If it does, can personal ownership be negated by an agreement between the physician and his association? The issue of ownership could be raised in any of several ways: a withdrawing associate might seek to take the records of "his" patients with him; a physician might refuse to produce subpoenaed documents on the ground that they are personal papers that may be withheld under the Fifth Amendment; etc. If such claims are upheld, there would be one more distinction between ordinary business corporations and professional associations upon which the Internal Revenue Service might rely to establish that the association is not a "corporation."

The preceding discussion has been concerned solely with the meaning of the first sentence of section 7 of the Georgia Act, which may be found, with minor variations, in most of the statutes under review. The second sentence of section 7 need not detain us so long, since, important as it may be in Georgia, it is not found in the statutes of other states. In denying the privilege of limited liability, if the member or shareholder "has personally participated in the transaction for which the debt or claim is made or out of which it arises," the second sentence of section 7 is not limited, as is the first sentence, to relations between the professional and the person receiving professional services. Rather, it appears to make it impossible for a member or shareholder to act solely in a representative capacity even in the non-professional aspects of the association's business. If he signs a lease, fires a secretary, or borrows funds, he is apparently personally liable, even though he purports to act solely on behalf of the association;¹⁷ and it may even be that he has "personally participated" in a transaction if it is effected by an employee or agent acting under his direction or supervision.

Since the second sentence of section 7 is idiosyncratic to Georgia, however, our main concern is whether the first sentence, in preserving the professional's relationship with his patient or client, is cor-

¹⁷ It is arguable that the term "personally participated" does not embrace transactions which the member or shareholder undertook in a representative capacity. But such a narrow reading of this part of section 7 is hard to accept, since non-representative transactions would not give rise to debts of or claims against the association. It is almost equally difficult to accept the notion that personal liability attaches to transactions in which the member or shareholder "personally participated" as a member or shareholder, but not to transactions in which he participated as an employee or agent of the association.

sistent with the kind of "limited liability" required by the Regulations promulgated under section 7701(a)(3):¹⁸

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.

Although the limited liability granted to shareholders of ordinary business corporations is sometimes subject to statutory exceptions,¹⁹ they infringe only slightly on the basic principle of limited liability. The first sentence of section 7, by contrast, subjects the professional to unlimited liability for the most important business risks of a professional practice, and grants immunity only from the less serious claims of landlords, suppliers, and employees. The difference is one of degree, to be sure, but it is a big one. If I read the first sentence of section 7 aright, I can only conclude that the limited liability it grants is too emaciated to satisfy the Regulations.

B. CENTRALIZED MANAGEMENT

Under the Regulations, an organization has "centralized management" if exclusive authority to make the management decisions necessary to the association's business is vested in one or more, but less than all, of its members.²⁰ Applying this standard to the Georgia professional association, we find that section 8 of the Georgia Act purports to centralize management in the Board of Governors to the exclusion of the membership.

Neither the Regulations nor the Georgia Act define the term "management." Is it limited to renting quarters, hiring and firing secretaries, purchasing supplies, and like details of housekeeping? Or, since the association is organized "for the purpose of carrying on a profession and dividing the gains therefrom,"²¹ does "management" also embrace professional decisions affecting the association's clientele, such as the patients to be accepted; the policies and routines to be followed in ordering laboratory tests, consultations,

¹⁸ Reg. Sec. 301.7701-2(d)(1) (1960).

¹⁹ For a description of "added liability" statutes, see 13A FLETCHER, PRIVATE CORPORATIONS §§ 6223 through 6581 (1961). Except for banks, where the added liability of shareholders is often limited to a specified amount rather than unlimited, these exceptions to the rule of limited liability are ordinarily confined to particular classes of debts, primarily wages due certain employees and debts for materials and supplies.

²⁰ Reg. Sec. 301.7701-2(c) (1960).

²¹ Ga. Act § 3, p. 36 *infra*.

and other diagnostic aids; the professional procedures to be employed or avoided; the keeping of records; the fees to be charged; etc.? The Georgia Act implies that the Board of Governors will sometimes make "decisions constituting the practice of [the group's] profession" since it forbids an unlicensed person to participate in such decisions.²² To the extent that this contemplates professional decisions by a Board of Governors composed of less than all of the members or shareholders, it is not easily reconciled with the preservation of the traditional responsibility of each professional to his patient or client²³ or with his continuing personal responsibility to the appropriate state licensing board.

But if the Board of Governors does not have control over the professional practice of the association's members, is management centralized as the Regulations require? To be sure, the general counsel or staff physician of a business corporation has professional responsibilities that he may not abdicate to the corporation's board of directors, and his independence does not impair the centralization of management in such corporations. But in such cases the independence of the attorney or physician is peripheral to the corporation's business activities, and the other corporate characteristics are ordinarily present in unalloyed form. With the professional association, however, professional practice is the be-all and end-all of the organization, and the professional independence in question is that of the members or shareholders, not merely that of an employee.

The question, then, is whether the members or shareholders of a professional association have authorized a fraction of their number to make "the management decisions necessary to the conduct of the business for which the organization was formed," as required by the Regulations,²⁴ in view of each associate's continuing personal responsibility for the conduct of his professional practice. Evidently each member in rendering professional services may, by virtue of the first sentence of section 7, bind the association with respect to its most important functions, *e.g.*, as to character of treatment to be provided, risks to be assumed, extent of cure warranted, fee to be charged, etc., as a member of a professional partnership may bind his firm. If so, there is a diffusion of power in the professional association that makes it more anarchic than totalitarian. I need hardly add that section 7701(a)(3) abhors anarchy. In my opinion, then,

²² Ga. Act § 8, pp. 37-38 *infra*. See also the restriction on participation in professional decisions by the estate of a deceased member. *Id.* § 10 pp. 38-39 *infra*.

²³ Ga. Act § 7, p. 37 *infra*.

²⁴ Reg. Sec. 301.7701-2(c)(1) (1960).

the professional association enjoys only a loose kind of centralized management, like the later Roman Empire, so that this corporate characteristic, though not totally absent, is too debilitated to get full credit in applying the Regulations.

C. CONTINUITY OF LIFE

The "corporate characteristic" of "continuity of life" is defined by the Regulations as freedom from dissolution upon the death, insanity, bankruptcy, retirement, resignation, or expulsion of a member.²⁵ Although section 9 of the Georgia Professional Association Act purports to confer on the professional association the same continuity of life that is granted to ordinary business corporations, an examination of other parts of the Georgia Act demonstrates that the association is not as immune to the vicissitudes of its members' private lives as section 9 at first suggests.

In keeping with the requirement that members or shareholders must be licensed to practice the profession in which the association is engaged, section 11 provides that a member or shareholder must sever his financial interest in the association upon losing his professional standing or accepting a public office that is inconsistent with rendering professional service. To aid in enforcing this requirement, section 13 requires the association to file an annual statement, certifying that all members or shareholders are duly licensed, and section 11 provides that an association with a disqualified member or shareholder may be dissolved. Even in ordinary business corporations, to be sure, the right to own stock is occasionally denied to certain classes of persons,²⁶ but I know of no parallel to the provision in section 11 for dissolution of the association if a disqualified member or shareholder does not withdraw.

It may be argued that section 11 is not inconsistent with continuity of life, because the tainted member or shareholder could be required to sell his interest to the association or to its members or shareholders if he fails to transfer it promptly to a qualified person. Indeed, section 12 provides that if the articles of association or by-laws do not fix a price at which a disqualified person's interest may be purchased, the price shall be book value as determined by an independent certified public accountant on the basis of the association's regular method of accounting. I doubt, however, that an association enjoys continuity of life within the meaning of the Regulations if it

²⁵ Reg. Sec. 301.7701-2(b)(1) (1960).

²⁶ See discussion p. 18 *infra*.

can avoid dissolution only by repurchasing the shares of a disqualified member, especially if its use of funds to effect such a repurchase is restricted by the state's general corporation law. On the other hand, if the association seeks to protect its continuity of life by providing in its articles or by-laws that an offending member may be "expelled" with a concomitant loss of his interest in the association, the possibility of such a forfeiture may impair or destroy the "free transferability" of the association's shares.²⁷

Not only a member's disqualification to practice or election to public office, but also his death, bankruptcy, or retirement may imperil the association's life. As to a member's death, section 10 states that a decedent's estate "may continue to hold stock or membership pursuant to the Articles of Association for a reasonable period of administration of the estate,"²⁸ but we are not told what happens when that period of time expires. If the estate has not found a qualified purchaser, must the association repurchase the membership lest it be dissolved for having an unqualified member? If so, the association's claim to immortality is weakened by the fact that the association may not have funds at the critical time to effect the repurchase,

²⁷ The statement in section 9 of the Georgia Act (and in parallel provisions of the statutes of other states) that the professional association "shall continue notwithstanding the . . . expulsion of any one or more of the members or shareholders" is puzzling, since we are told nothing about the permissible grounds for expulsion or about its legal consequences. Does expulsion carry with it a forfeiture of the member's entire interest in the association? Does it leave his economic interest intact, provided he disposes of it to a qualified person within a reasonable period of time, as in the case of the estate of a deceased member? Does it result only in the loss of the member's right to vote? May the charter or by-laws provide for expulsion without cause, in the same manner that they may provide for removal of directors without cause? No matter how these questions are answered, and despite the statutory assurance that the expulsion of a member will not disrupt the organization's continuity of life, the concept of expulsion is more compatible with the traditions of partnership law than with those of corporate law.

²⁸ If the association's earnings are not fully distributed during this interim period as salaries to the active members, the estate will evidently share in professional fees, either through dividend distributions or by reason of the increase in its equity, in violation of the ethical rules of some professions, *e.g.*, law. If this result is avoided by a system of allocating the undistributed income to the shares of the active members, thus sterilizing the shares of the deceased member during this interim period, there will be a departure from the usual rule of corporate law that one share is as good as the next. *See* note 12 *supra*.

I do not mean to suggest that the estate of a deceased partner could not receive a share of the firm's fees earned in future years as a substitute for its share of the firm's assets at the date of death. *See, e.g.*, the agreement in *Carter v. Comm'r*, 36 B.T.A. 60 (1937). But if the estate, by reason of the decedent's membership in a professional association, can sit passively by while its equity in the firm increases in value by reason of the services of the remaining members, an ethical question seems present. I am not sure that the agreement in *Coates v. Comm'r*, 7 T.C. 125 (1946), would be proper for a law firm, unless the estate's share of the post-death earnings represent payment for its share of the firm's good will at the date of death.

or may be forbidden by state law to use its funds for this purpose. If the estate's failure to find a qualified purchaser within the specified period results in a forfeiture of the membership, the association's continuity of life will be protected, but the membership's "free transferability" is then impaired. The Georgia Act is equally obscure on the consequences of a member's bankruptcy. When his interest passes to a trustee in bankruptcy, does it evaporate if the trustee cannot find a qualified purchaser? Or must the association repurchase the interest under pain of dissolution for having an unqualified shareholder or member? Similarly, as to retirement, may a member or shareholder who retires from practice retain his shares? If not, what is the penalty for his failure to transfer them?

I do not claim to know the answers to these questions, but I do not see how continuity of life can be claimed for the association until the answers are vouchsafed to us.

D. FREE TRANSFERABILITY OF INTERESTS

For most professional groups, the concept of freely transferable membership is ludicrous. The Georgia Professional Association Act provides in section 10, however, that shares or memberships "shall be freely transferable except as may be lawfully restricted in the Articles of Association," subject to the requirement that members or shareholders must be legally authorized to practice the appropriate profession. Although this is not clear, it may be that members and shareholders not only must be legally qualified to practice, but also must be actually engaged in practice. At any rate, a requirement of active practice might be implied from section 3, which states that two or more licensed persons may form a professional association "by associating themselves for the purpose of carrying on a profession and dividing the gains therefrom." And it may be imposed on lawyers, and perhaps some other professional persons as well, by an ethical prohibition of splitting fees with persons who perform no services. I am doubtful, in other words, that the Georgia Act contemplates a passive investment in the stock of an association engaged in the practice of law or medicine by a person who, though licensed to practice the profession, is inactive or retired.²⁹

²⁹ In providing that a member's "retirement" shall not terminate the association's life, section 9 of the Georgia Act may imply that a retired member must cease his participation in management, give up his vote, dispose of his shares, or otherwise limit his relationship to the association. This implication is strengthened by section 12, which refers to "deceased, retired, expelled, or disqualified" members and then speaks of "the end of the month immediately preceding the death of or disqualification of the member," thus suggesting that retirement is a species of "disqualification" requiring the member to dispose

But whether the ownership of the professional association is restricted to active practitioners or only to licensed persons, its shares are less freely transferable than shares of the ordinary business corporation. The adverse market effect of a restricted range of potential transferees might be mitigated somewhat if the association were required to buy any shares tendered to it, but there is no such requirement. A member who wants to dispose of his membership must find a buyer by his own unaided efforts. This does not mean that the shares are non-transferable, but their "free" transferability is impaired. It is, of course, true that the range of purchasers for the shares of ordinary business corporations is sometimes restricted by law: alien ownership may be prohibited; purchase by a competitor is forbidden by the Clayton Act; etc. But these restrictions are appreciably less onerous than the one we have been examining.³⁰

Though the range of potential purchasers is so narrow as to raise doubts about the free transferability of the shares, it is probably too broad to be tolerated by any professional association. At any rate, I cannot envision an association that would fail (except through neglect) to restrict transferability still further by requiring shares or memberships to be offered to the association or to the members before sale to an outsider.³¹ Such a restriction does not in itself negate the existence of the corporate characteristic of free transferability, however, since the Regulations provide:³²

If each member of an organization can transfer his interest to a person who is not a member of the organization only after having offered such interest to the other members at its fair market value, it will be recognized that a modi-

of his stock. As with expulsion (*see* note 27 *supra*), changes in the member's relationship to the organization resulting from retirement are more consistent with the traditions of partnership law than with those of corporate law. In authorizing Florida lawyers to practice through professional corporations, *supra* note 7, the Florida Supreme Court provided in its rules that the practice may continue only while all shareholders of the corporation are active members of the Florida Bar in good standing. Under this rule, the firm must apparently cease its practice immediately upon the death, retirement, or disbarment of a shareholder, unless his share is promptly transferred to a qualified person or acquired by the remaining shareholders or the firm.

³⁰ In *Louis K. Liggett Co. v. Baldridge*, 278 U.S. 105 (1928), the Supreme Court held that a Pennsylvania statute requiring the shares of incorporated drug stores to be owned by registered pharmacists was unconstitutional. Without wishing to endorse the decision, I offer it as evidence that limitations on the right to own stock are rare indeed.

³¹ The members of a professional corporation might well wish to buttress the corporation's option to buy the interest of an outgoing member with a provision *requiring* such action if any one of the remaining members insists on it. Otherwise the board of directors could let the option lapse if the proposed transferee was acceptable to a majority of the remaining members or directors. Such a device for requiring unanimity in the admission of new members could be regarded either as an impairment of the centralization of management or as a "factor" characteristic of a partnership. *See* note 12 *supra*.

³² Reg. Sec. 301.7701-2(e) (2) (1960).

fied form of free transferability of interests exists. In determining the classification of an organization, the presence of this modified corporate characteristic will be accorded less significance than if such characteristic were present in an unmodified form.

In accepting, though denigrating, this modified form of transferability, the Regulations speak of an option in the other members to purchase the interest *at its fair market value*. Will an option to purchase at a price that does not take into account the value of good will be satisfactory? A brief detour is necessary before attempting to answer this question. First of all, we may take note of the long dispute over the mere existence of professional good will, in which taxpayers have customarily argued that good will can attach to the conduct of a profession and that it can be transferred by one professional man to another. The Internal Revenue Service has finally conceded that "goodwill may be recognized in connection with the sale of a business [the context indicates that this term includes the practice of a profession], the success of which is *not* dependent solely upon the personal characteristics of the owner, even though such sale does not comprehend a valid assignment of the exclusive use of the firm name."³³ Since the successful practice of a profession by some—perhaps most—professional associations will generate good will, it probably must be taken into account in fixing the price at which a member's interest may be repurchased by the association if the parties wish to bring themselves within the "fair market value" requirement of the Regulations. If in order to avoid paying for good will, the parties attempt to create individual ownership of each member's contribution to the association's good will in negation of group ownership, they may impair their claim that the organization is an "association."

When a withdrawing member intends to continue in practice, a stronger case can be made for the proposition that he will not leave any good will behind him, but the case may not be strong enough. The Georgia Act does not tell us whether such a member is subject to any restraints in accepting patients or clients with whom he became acquainted while employed by the association. May he apprise them of the termination of his relationship with the association and of his new address? Does section 7 give him the right to take the records of "his" clients with him? Are these questions subject to regulation by the association's articles of association or by-laws, or are they to be answered by extrapolation from the statute, the principles of equity, and the canons of professional ethics?

However these substantive issues may be resolved, a failure to

³³ Rev. Rul. 60-301, 1960-2 CUM. BULL. 15.

require payment for such good will as may be enjoyed and retained by the association would be inconsistent with the "fair market value" requirement of the Regulations. Although the Regulations do not affirmatively state that an option in the members to buy a withdrawing member's interest for less than fair market value is necessarily fatal to the existence of free transferability, the fact that a fair market value option is merely tolerated by the Regulations ("this modified corporate characteristic will be accorded less significance. . .") implies that the Government, at least, will not be very hospitable to options to buy for less than fair market value. This in turn means that an option to purchase at book value, as provided by section 12 of the Georgia Act,³⁴ and as commonly found in agreements among the shareholders or partners of a closely-held enterprise,³⁵ would endanger a professional association's claim, already enfeebled, to free transferability of shares.

Even if the option employed by the professional association to insure *delectus personae* conforms to the Regulations by requiring the associates to pay fair market value for the interest of a member or shareholder who wishes to get out, the Government might argue that free transferability does not exist even in "modified" form if, realistically viewed, there is no significant likelihood that shares could actually be transferred to outsiders without a complete reorganization of the group's professional and financial arrangements. In the case of most small groups of professional men, a transfer of a share would be so likely to bring about a complete reshuffling, that it is difficult to perceive the kind of free transferability described in the Regulations:³⁶

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 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

³⁴ The relationship of section 12 of the Georgia Act to the provision in the income tax Regulations on options is not clear. The Regulations are primarily concerned with restraints on voluntary transfers, whereas section 12 is concerned primarily, if not solely, with involuntary transfers. In any event, the book value formula of section 12 is inapplicable if the association's articles or by-laws provide another method of computing the price.

³⁵ I do not mean to suggest that an ordinary business corporation loses its status because of a stock purchase agreement permitting it to buy the shares of a retiring or deceased shareholder at a low or even nominal amount. But what is permitted with respect to an organization that otherwise meets all the tests of "corporateness" may not be tolerated in an organization which either is on the outside seeking entrance or is at best hovering perilously on the frontier.

³⁶ Reg. Sec. 301.7701-2(e) (1) (1960).

in the organization. Thus, the characteristic of free transferability of interests does not exist in a case in which each member can, without the consent of other members, assign only his right to share in profits but cannot so assign his rights to participate in the management of the organization.

MY VERDICT

The Georgia professional association possesses the corporate characteristics of "associates"³⁷ and "an objective to carry on business for joint profit," but these must be disregarded under the Regulations because they are common to both corporations and partnerships. As to the remaining four corporate characteristics, my scorecard reads:

Limited liability:	Doubtful
Centralized management:	Present in modified form
Continuity of life:	Doubtful
Free transferability:	Doubtful in most cases. ³⁸

Under the Regulations "an unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics. . . ."³⁹ How are we to classify an organization that possesses one attenuated corporate characteristic if its other three characteristics are neither "corporate" nor "noncorporate," but borderline? It would be possible to interpret the Regulations as classifying such an organization as a corporation, but it seems to me more likely that the

³⁷ In Ohio and Pennsylvania, one person may organize a professional association. I have elsewhere expressed the view that a one-man association should be no more surprising than a one-man corporation. BITTKER, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* § 2.07 (1961). But the Regulations evidently deny corporate status to a business organization that has only one "associate." Reg. Sec. 301.7701-2(a)(2) (1960). Even if it surmounts this obstacle, a one-man professional association may lack continuity of life and centralized management. See also note 42 *infra*.

³⁸ Example (1) of Reg. Sec. 301.7701-2(g) (1960) recognizes the presence of a modified form of free transferability in a seven-man medical clinic whose members may transfer their interests to other doctors subject to an option in the group, exercisable by majority vote, to purchase at fair market value. I assume that such an arrangement may correspond to reality in the case of some medical clinics. If the group's pediatrician retires or dies, the others may be content in many instances to have his membership transferred to another pediatrician who is acceptable to a majority, but not to all, of the remaining members, and the entry of the new member may not produce a complete reshuffling of the relations of the members to each other. But this degree of free transferability would not exist in many professional groups. See *Brooks v. Comm'r*, 36 T.C. No. 113 (1961), where the Court said of a dental practice carried on through several offices with hired dentists that "[n]o personal professional qualifications of . . . [the dominant figure in the firm] entered into the success of the practice at all." Under these circumstances, I presume the firm, or interests in it, can be bought and sold freely. I also presume that not many professional firms would wish to minimize the role of personal qualifications to quite this extent.

³⁹ Reg. Sec. 301.7701-2(a)(3) (1960).

group must affirmatively establish that it possesses at least three corporate characteristics to qualify as a corporation. I conclude, therefore, that the Georgia professional association does not meet the standards of the Regulations.

The professional association statutes of Connecticut, Illinois, Ohio, and Pennsylvania are not identical with the Georgia Act or with each other, and the following distinctions are worthy of note:

CONNECTICUT

In adopting the Uniform Partnership Act, Connecticut added a new provision, obviously based on the 1960 Regulations under section 7701(a)(3) and, indeed, employing some of the same phraseology. It provides that three or more persons licensed to practice a profession may organize an association "if the articles of association of the members provide that the association . . . shall have at least three of the following four attributes," the four attributes being continuity of life, centralized management, limited liability, and free transferability of interests.

The Connecticut statute is puzzling, however, in its failure to state affirmatively that the attributes provided in the articles are legally binding on members of the public, especially those without notice.⁴⁰ In this respect, the Connecticut statute is different from the other legislation under review as well as from typical state corporation laws, which say flatly that the group or organization shall have the attributes in question. Although the language of the Connecticut statute may be interpreted to mean merely that the associates may elect to avail themselves of only three of the four attributes rather than employing all four, and that those that are selected shall be legally effective, it is not inconceivable to me that the provisions of the articles bind only the associates and persons with actual notice, and that other members of the public are not affected by restrictions on an associate's personal liability or on his authority to bind the group by his individual act.⁴¹

⁴⁰ The group that won recognition as an "association" in *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954), provided in its articles of association for centralized management, continuity of life, and a form of limited liability. The Court relied on these provisions in finding that the group was an association, without discussing their legal force under state law. *See also* *Galt v. United States*, 175 F.Supp. 360 (N.D. Tex. 1959), which similarly accepts the language of the articles of association at face value. In its Regulations, however, the Treasury refuses to honor provisions in an agreement that are unenforceable under local law. Reg. Sec. 301.7701-2(g), Example (2) (1960).

⁴¹ Otherwise the Connecticut professional association might engage in a modified shell game (one shell, four peas) by requiring the public to ascertain from an examination of

The Connecticut law is also distinctive in lacking the conventional "professional relationship" clause found in Georgia and other states, although perhaps the same result will be achieved through a liberal reading of section 44(3), providing that the association "shall be subject to the laws of the State of Connecticut regulating the practice of the profession of the individual members of the association." If so, the statutory assurance of centralized management is weakened by the authority vested in the individual practitioner by the rules of his profession, in the same way that centralized management of the Georgia professional association is relaxed by section 7 of the Georgia Act.

By restricting membership to professionally licensed persons (perhaps, inferentially, to active practitioners), the Connecticut statute impairs the free transferability of membership, as does the Georgia Act, and it may also threaten the group's continuity of life if dissolution is an appropriate remedy for a failure to expel a disqualified member. As to limited liability, the articles may provide against personal liability for the association's "debts" (not debts and claims as in some other statutes), but the associates "shall in no way limit their individual or several liability in the articles of association, or otherwise, for any acts of reckless or wanton misconduct, negligence, malpractice, professional misconduct, or tort." In addition to preserving the member's personal liability for his own misconduct, this proviso may expose him to personal liability for the misconduct of his fellow members and perhaps also for that of the association's employees and agents. At any rate, I see no other function for the reference in the clause to a member's "several" liability.

ILLINOIS

The Illinois statute contains conventional provisions for centralized management and continuity of life,⁴² but they grant less than

the articles of association which of the four peas, if any, is covered by the shell. As to limited liability under the Connecticut statute, it should be noted that there is no requirement that the associates subscribe or pay in any amount to the treasury of the association, and they are apparently free at any time to withdraw any funds that may be accumulated by the association, whether the association has creditors or not. Unless restraints on such practices are to be found in the law of fraudulent conveyances, this freedom might well lead the Connecticut courts to interpret the legislation rather narrowly.

⁴² Continuity of life is qualified by a reference in section 7 of the Illinois law to "the last surviving member," implying that an Illinois association must be dissolved if its last surviving member dies, becomes bankrupt, etc. This may be an implicit limitation on continuity of life for all professional associations and corporations: if a firm has only a single member or shareholder, and he dies or becomes disqualified, there will be an

they promise because of the "professional responsibility" clause and the denial of membership to unlicensed persons. As to limited liability, there is an unexpected void; possibly something is to be poured into it after being drawn by inference from the opening statement that duly licensed professional persons "may form a professional association, as distinguished from either a partnership or a corporation." Another possibility, equally speculative, is that limited liability is obtained, subject to the "professional relationship" clause, because the association is engaged in practice as a principal, not as the agent of its members. The transfer of "shares or units of ownership" to other licensed persons is permitted; this term probably is intended to mean the same as "membership" (the term used elsewhere in the statute), but it is also possible that the distinction embodies the rule of partnership law that a partner may assign his "interest" in a partnership, but not his membership.

OHIO

The Ohio statute is similar to the Illinois statute in most respects, including its failure to provide expressly for limited liability. This omission, however, is evidently remedied by the incorporation by reference of all consistent portions of the Ohio general corporation law.⁴³

PENNSYLVANIA

The Pennsylvania statute expressly negates limited liability by providing that the associates (a) are jointly and severally liable for the torts of any agent or employee acting within the ordinary course of the association's operations and for certain misapplications of funds, and (b) are jointly liable for all other debts and legal obligations of the association. Pennsylvania is unique also in specifically providing that an associate who becomes disqualified to render professional services "shall be immediately expelled from the association." This provision strengthens the association's claim to continu-

interregnum before a qualified transferee can take over, during which the continuation of business will evidently be unlawful. It is not clear whether the firm must be dissolved upon the occurrence of such an event. Some statutes (*e.g.*, section 15 of the Oklahoma Act, note 2 *supra*) require the firm to repurchase the shares of a deceased or disqualified shareholder within a prescribed period of time. In the case of a one-man corporation, compliance with this requirement would produce a corporation without shareholders. Would it belong, like *ferae naturae*, to whoever reduces it to possession?

⁴³ I have put the Ohio statute in the "association" group, since that is the label it employs, but I should note also that it speaks of the group's governing agreement as "articles of incorporation."

ity of life, which under the statute is to continue despite a member's "expulsion," and by empowering the expelled member to transfer his membership interest, the statute protects him legally, if not realistically, against a forfeiture. The Pennsylvania law lacks a "professional relationship" clause, but as a restriction on limited liability, it is not needed in Pennsylvania, and the rest of its content may be supplied by the provision that "professional services shall be rendered subject to rules and regulations of the professional licensing boards."

On balance, I am not persuaded that the Connecticut, Illinois, Ohio, or Pennsylvania statutes, despite their divergent departures from the Georgia Act, should be treated differently. In none are the four corporate characteristics assured beyond doubt; all leave a good many troublesome questions of state law to be answered in future years; and, for reasons to be set out later, neither the Treasury nor the federal courts should attempt to extrapolate such a formidable corpus of state law in passing on federal income tax claims when this uncongenial task can be avoided.

"PROFESSIONAL CORPORATIONS" STATUTES

In a number of instances, the state legislation under review permits professionals to carry on their practice through "corporations" or "professional corporations." The most direct route to this result would have been to amend the state's general corporation law to override any legislative, common law, or administrative restrictions on the right of ordinary business corporations to practice the profession in question. But the statutes are not so simple, evidently because the state legislatures believed that the nature of professional practice called for restrictions to which ordinary business corporations are not subject. Thus, the statutes preserve the professional relationship and the professional's liability to his patient or client⁴⁴ and prohibit the ownership of shares by unlicensed persons.

Do these "corporations" or "professional corporations" constitute "corporations" as this term is used in the Internal Revenue

⁴⁴ Tennessee may be an exception, in that it does not include an explicit provision like section 7 of the Georgia Act. Perhaps a preservation of the professional relationship should be read into section 61-105(3)(d) of the Tennessee law, providing that "the association . . . will be subject to the laws of the State of Tennessee regulating the practice of the profession. . . ." But see paragraph (3)(c), which permits the articles to negate personal liability for the debts of or claims against the association. Perhaps the dialogue I imagined (*supra* p. 9) did not take place in Nashville. There are similar omissions in Connecticut and Pennsylvania, both "association" rather than "corporation" states. See discussion pp. 22-25 *supra*.

Code? To the best of my knowledge, this is a novel question in the sense that until now all organizations bearing the label "corporation" under state law have, without further inquiry, been accorded that status for federal income tax purposes,⁴⁵ the only debate in this area having been concerned with the classification of organizations that are *not* labelled "corporations" by state law.

The term "corporation," however, is not used in the Internal Revenue Code to embrace all organizations to which a state chooses to apply the label "corporation," any more than state use of the label "association" automatically makes the group an "association" under section 7701(a)(3). Rather, the Code uses the term "corporation" as a brief summary of a group of legal consequences attached by state law to a business organization.⁴⁶ To take an extreme example, if Hawaii were to amend its version of the Uniform Partnership Act by striking out the word "partnership" throughout and substituting the word "corporation," this species of Hawaiian "corporation" would not be regarded as a "corporation" for federal income tax purposes.

If therefore the state law label is not sacrosanct, the first step in classifying a business organization for federal income tax purposes is to ascertain its legal consequences under state law. This is the method by which we have long determined whether or not an unincorporated group is to be treated as an "association" and hence as a "corporation," and there is no reason to flinch from employing the same process in deciding how a new-style professional corporation shall be taxed. In this connection, I should note that this route is not a one-way street. If the history of tax litigation teaches us anything, it demonstrates that whatever position the Government may adopt today, by tomorrow some taxpayers will argue that professional corporations are not federal income tax "corporations," so as to justify, for example, a deduction for business losses on their individual returns. Unless these taxpayers are estopped by the label they adopt, they will unquestionably invoke the criteria that are embodied in the Regulations under section 7701(a)(3) to establish that professional corporations are "really" partnerships.

It is arguable, of course, that the Regulations under section 7701(a)(3) have no applicability to the professional corporation because they are expressly concerned with the proper classification of "unincorporated" groups. This argument is tinged with question-begging, since it implies that the state label "corporation" nullifies the applicability of the Regulations. Even if we accept the inap-

⁴⁵ Occasionally, of course, a corporation is disregarded as a "dummy" or "sham."

⁴⁶ See note 5 *supra*.

plicability of the Regulations, however, it does not follow that the criteria it employs for classifying business organizations are irrelevant. Indeed, if the Regulations under section 7701 did not exist, we should probably have to invent something like them. What I am suggesting, in short, is that the principles of the Regulations afford as good a guide as we are likely to find for determining when a self-styled "corporation" should be treated as such.

In applying these principles to the professional corporation, I feel that most of the remarks and questions in my discussion of the Georgia Professional Association Act are relevant.

Clauses in the professional corporation laws preserving the "professional relationship" detract, as in the case of the Georgia professional association, from the limited liability ostensibly enjoyed by the shareholders and serve also to weaken the corporation's centralized management. All of the statutes under review provide that shares of the professional corporation may be issued and transferred only to persons who are duly licensed to practice the profession, but with variations in the remedies and penalties for non-compliance. In Florida, non-compliance is a ground for "dissolution" of the corporation; in Wisconsin it warrants "suspension or forfeiture of [the corporation's] franchise." Arkansas, Minnesota, and South Dakota, whose statutes authorize only medical corporations, provide that the corporation's certificate of registration may be revoked by the state medical board after a hearing and possibly subject to judicial review. But it is not clear whether revocation of the certificate upon the disqualification of a shareholder is mandatory or only discretionary. Oklahoma and Tennessee fail to provide any specific remedy for non-compliance, presumably relegating this matter to the statutory or common law governing violations of the state's general corporation law.

Although the professional corporation statutes probably need not have explicitly authorized the corporation or its shareholders to require stock to be offered to them before a sale to outsiders, all, except Tennessee and Wisconsin, regulate this matter to some extent. The Florida statute goes further, requiring any sale or transfer of shares to be approved by at least a majority of the other shares at a special stockholders' meeting, a restriction that negates the claim that the shares are freely transferable. Like the Georgia Professional Association Act, most of the professional corporation statutes provide that the shares of a disqualified shareholder shall be repurchased at book value, but permit the charter or by-laws to adopt a different valuation formula.

Little is said in the professional corporation statutes about cen-

tralization of management, no doubt because the provisions of the general corporation law governing this area were thought to be satisfactory without modification. I have already discussed the possibility that the relationship between the professional and his client or patient is inconsistent with "centralized management" because of the professional's continued independence in both his contractual and his non-contractual relationships with the patient or client, his control over the professional records, his professional responsibility with respect to fees, etc.

In my opinion, the professional corporation statutes are no more efficacious than the professional association statutes in achieving the federal income tax status of "corporation."

HOW SHOULD DOUBTS BE RESOLVED?

In arguing that professional associations and corporations (1961 model) should not be classified as "corporations" within the meaning of section 7701(a)(3) of the Internal Revenue Code, I have relied thus far upon their private law consequences under state law. In the course of making an ultimate judgment, there is no escape from a series of subordinate judgments about the meaning of the state statutes; and there obviously is room for a difference of opinion on a number of these preliminary issues. Even if a contrary resolution of some of these issues should bring the professional association or corporation to the borderline between partnership and corporation, however, it seems to me that there are a number of good reasons why doubts should be resolved by denying corporate status.

A. FEDERAL VERSUS STATE JURISDICTION

The appropriate manner of applying the federal income tax to professional persons is a basic policy decision, involving comparisons between earned income and investment income, the weight to be accorded to the legal form in which business is conducted, the extent and importance of "bunching" of professional income, the significance of self-employment, the demands of the revenue, etc. The states do not pretend to, and cannot, weigh these competing claims; that is a federal responsibility.

It is inevitable, of course, that the states in the course of regulating personal and business behavior will affect the federal income tax burden of their citizens: a state inheritance tax has a different federal tax result from a state income tax; community property is

taxed differently from common law property; the taxation of income from property held in joint tenancy depends upon the rights of the parties under state law; state law on the obligation of support controls the taxation of certain trust income; etc.

But most rules of state law are formulated with little or no thought of their federal tax results. There are exceptions, of course, in which state legislation has been enacted for the primary or sole purpose of gaining some federal tax advantage. One example is a recent Connecticut statute providing that the widow's right to an allowance for support during administration of her husband's estate shall not be divested by her death.⁴⁷ The obvious legislative purpose was to insure that the allowance would qualify for the federal marital deduction. Other instances could be cited. But even though some provisions of state law have as their sole purpose a change in federal tax liability, they are ordinarily not without other substantive consequences, and the effect on the federal exchequer of such changes is almost always minor.

By contrast, the statutes permitting the organization of professional associations and corporations have no apparent purpose other than federal tax reduction, they alter the non-tax results of professional practice in only minimum degree, and they would have, if successful, a substantial effect on the federal revenue. I can think of no comparable outburst of state legislation in a half century of federal income taxation other than the community property episode described at the commencement of this article, and even this one, despite the primary purpose of reducing the federal income tax liability of married couples, would have produced private law consequences of enough importance, especially in the case of broken marriages, to be defended as an exercise of traditional state jurisdiction over domestic relations. Much less can be said for state enactment of the legislature here under review, which aspires to inflict heavy casualties on the federal Treasury while leaving the state's non-tax law virtually unscathed.

It may be argued in reply that it is the states that prevented physicians and attorneys from practicing in corporate form and thus obtaining the federal tax advantages of corporations, and that the

⁴⁷ Pub. Act No. 370, amending CONN. GEN. STAT. § 45-250, 1961 CONN. LEGIS. SERV. 539. Occasionally a mere change in the label affixed by a state to an event or transaction is efficacious in altering its federal income tax result, but these instances are trivial both in themselves and in the aggregate. *See*, for example, Rev. Rul. 54-50, 1954-1 CUM. BULL. 55, allowing the consumer to deduct an Oklahoma cigarette tax after the state changed its law to provide that the "impact" of the tax was "on" the consumer, although the tax was collected from wholesalers.

states do not infringe any federal prerogative if they repeal these prohibitions, even if they do so primarily or solely to reduce the federal tax liability of the affected taxpayers. I am prepared to grant that if a state were to repeal the statutory, common law, or administrative rules that have forbidden corporations to practice the professions, its physicians and attorneys could organize corporations that would qualify as such under section 7701(a)(3), and if Congress objected, it would have to move affirmatively to deny that status to corporations engaged in professional practice. But the state legislation under review, instead of taking this course, combines the award of a label with a bit of nibbling away at the fringes of partnership law, and I see no reason to encourage such schemes for indirectly amending the Internal Revenue Code.

B. RECENT FEDERAL TAX HISTORY

It cannot be claimed that state intervention in this area has become necessary because of the failure of Congress to consider the claim of professional groups that they are being unfairly denied the tax advantages of corporations. Nor can doubts in interpreting section 7701(a)(3) be resolved by assuming that Congress would wish to give them corporate status. To the contrary, these claims have been vociferously brought to the attention of Congress, and Congress has demonstrated that it is in no hurry to accede to them.

This was the message of Congressional action in 1954, when section 1361 was enacted to permit unincorporated business enterprises to elect to be taxed as corporations. The stated purpose of this provision was to permit "the business to select the form or organization which is most suitable to its operations without being influenced by Federal income-tax considerations."⁴⁸ If businesses that would find it inconvenient to use the corporate form were to be allowed to elect to be so taxed, one would have thought that the option would be thrown open, a fortiori, to physicians and others who could not organize corporations even if they wished to do so. But Congress deliberately confined the election to enterprises in which "capital is a material income-producing factor" or which are engaged in certain types of trading activities, with the result, as the Senate Finance Committee pointed out, that "firms engaged in professional services such as the law, accounting, medicine, engineering, and others" are excluded from section 1361.⁴⁹

Even if this limitation on section 1361, enacted with knowledge of

⁴⁸ H.R. 8300, S.REP. No. 1622, 83d Cong., 2d Sess. 119 (1954).

⁴⁹ *Ibid.*

state hostility to corporate practice of the professions, is not an affirmative Congressional declaration that professional groups should be taxed as proprietorships and partnerships, it certainly is not hospitable to a relaxation of the standards under section 7701(a)(3) to permit such groups to claim the status of "corporations."

A similar lesson may be found in the history of Congressional action on the Jenkins-Keogh bill and related proposals to permit self-employed persons to establish qualified pension plans.⁵⁰ The keynote of the proponents of such legislation has been "equality" between employees and the self-employed, and their principal focus has indisputably been the professions that may not be practiced in corporate form. I need not remind readers of this Review of the time and thought, to say nothing of oratory, that have been devoted to this "quest for tax equality"⁵¹ or of the knotty problems that arise in the effort to apply the abstract concept of equity to the concrete issue of retirement benefits. These problems would multiply, not diminish, if some of the principal groups who would be affected by the proposed Congressional legislation should obtain in some states the right to be taxed as corporations by utilizing a new form of business organization. Until now the disparity that Congress has been attacking arose from the fact that most professional persons are forbidden to incorporate, while most business firms have a choice, and it has been thought that even if this disparity cannot be eliminated,⁵² its reduction will alleviate the problem and will at least leave all professionals in the same boat. The new element introduced by this rash of state legislation is that *some* practitioners in *some* states may now organize professional associations and corporations which, if recognized as "corporations" under section 7701(a)(3), will confer tax-savings on them that are denied to other professional persons.

A distinction that is tolerable if it separates lawyers from television repairmen may be intolerable if it separates New Jersey law-

⁵⁰ The history of these proposals may be found in Rapp, *The Quest for Tax Equality for Private Pension Plans: A Short History of the Jenkins-Keogh Bill*, 14 TAX L. REV. 55 (1958), brought up to date by the same author in Rapp, *Pensions for the Self-Employed: The Treasury Department-Finance Committee Plan*, 16 TAX L. REV. 227 (1961). See also *Hearings Before Senate Finance Committee on H.R. 10*, 87th Cong., 1st Sess. (1961), and a sequel reported in P-H BULL., Aug. 31, 1961, 4 P-H ¶ 32,411 (1961).

⁵¹ Rapp, *supra* note 50.

⁵² Whatever form a self-employed pension law may take, it is almost certain to leave a residue of tax distinctions between self-employed persons and owner-managers of small corporations. Though not to be encouraged, such residual distinctions may be excused on the ground that lawyers and doctors are not, after all, interchangeable with the owners of machine shops and grocery stores, and that fireside equity is sufficient.

yers from Pennsylvania lawyers; and such a change in our threshold of tolerance for inequality would require a far more refined self-employment pension law.⁵³ I do not mean to suggest that this would be a bad thing or that the protracted study by Congress and the Treasury of the tax status of professional persons constitutes an investment in research and development that must be protected against expropriation by the state legislatures. I do think, however, that state legislation designed to outflank Congress and the Treasury ought not to be encouraged, especially when it is directed at a problem under active Congressional study and has so meager a non-tax content as to be virtually devoid of business purpose. I might add that the state legislation would by no means eliminate the problem which the self-employed pension bills seek to solve: some states have no such legislation; not all professions are covered; non-professional self-employed persons who cannot effectively incorporate, *e.g.*, commission salesmen, are omitted; individual practitioners are often excluded; and the taxpayer's choice of business form would continue to control his federal tax liability.

C. THE ROLE OF THE TREASURY AND THE FEDERAL COURTS

The state legislation under review has created a new species, possibly several new species, of business organizations, but we have been given only the sketchiest of guides to their behavior. Authoritative answers to the questions I have raised, and to others that are bound to reveal themselves, can come only from the state courts, and only as experience sharpens the issues and presents them for judicial resolution. The Treasury will no doubt be asked to rule that these organizations are taxable as "corporations," if requests for rulings are not already pending. A favorable ruling presupposes that the Treasury can decide with reasonable assurance the scope of the shareholders' personal liability, the effect of the professional relationship on the purported centralization of management, the impact of disqualification, bankruptcy, and other events on the transferability of the shares and the continuity of the group, and a host of other state law questions to which the answers are obscure and may vary from one state to another.

⁵³ It is, of course, possible that federal recognition of professional corporations and associations would take some of the steam out of the Jenkins-Keogh movement, thus stranding those professionals whose geographical location, profession, or other circumstances make professional incorporation impossible. See the question of Senator Anderson in the Hearings on H.R. 10: "My point is, why do we have to have H.R. 10 plus this [state professional corporation laws]?" *Hearings, supra* note 50, at 154.

I intend no disparagement of the legal skill of the Treasury's lawyers in urging that they are not the proper persons to work out a corpus of private law governing the internal and external affairs of these novel organizations, in an ex parte procedure that cannot insure that all of the proper questions will be asked, let alone be adequately argued. It is, of course, true that the Treasury must often make preliminary decisions about the private law effect of a contract, statute, or other legal event in order to rule on its federal tax consequences, and I suggest no change in this practice. What I am saying, simply, is that the magnitude and novelty of the issues to be determined deserve attention; here they seem to me to militate against Treasury action at this time. Advisory opinions by the Treasury, whether embodied in the Regulations, in taxpayers' ruling letters, or elsewhere, are a discretionary function, and there are times when delay is an appropriate administrative response to requests for advice. This is especially so when litigation is inevitable, so that the Treasury will not have the final word, as it does in practice, though not in theory, in the corporate readjustment area (where a refusal to issue rulings often induces paralysis in our captains of industry), and when the tax issue is entwined with state law, so that the Treasury's views are likely to carry little weight with the courts because of a palpable absence of the administrative expertise that, rightly or wrongly, is thought to inform its action in other areas.

Sooner or later, of course, the Internal Revenue Service will have to issue instructions to its agents, but by the time this becomes necessary there may be a body of state decisions answering some of these questions and affording a basis for extrapolating answers to others. If not, the Treasury would do well, in my opinion, to follow the approach of its Regulations under section 7701(a)(3), which, by stating that an unincorporated organization is to be classified as an "association" only if it possesses more corporate characteristics than non-corporate characteristics, resolves borderline or equiponderant cases by denying corporate status.

As to the federal courts, if income tax disputes must be decided before authoritative state court guides to the private law attributes of the professional association or corporation are available, they too might well be reluctant to develop a corpus of private law in the absence of such vitally affected parties as patients, clients, and professional licensing boards. Moreover, they may be spared this arduous duty by the inability of taxpayers, who have the burden of proof, to establish that the professional association or corporation has the

necessary corporate attributes if the only evidence is the naked language of the state statute.

D. A CLOUD ON THE HORIZON: THE "PROLETARIAN CORPORATION"

Recognition of professional associations and corporations would pave the way to enactment of similar legislation for a much larger group of persons who are not now covered by qualified pension and profit-sharing plans, *viz.*, employees whose employers have not seen fit to establish such plans or who do not meet their employer's pre-requisites for eligibility. It is often forgotten that only about 26 million members of a labor force of about 70 million are covered by existing plans, and that many of those who are covered will receive inconsequential benefits because their employers are contributing less than the maximum amount legally deductible and because the postponement of vesting results in many forfeitures.

Recognizing these facts, some of the predecessors of the Jenkins-Keogh bill were not restricted to self-employed persons, but also embraced employees who were not covered or were inadequately covered by plans established by their employers. But if state action turns the trick for lawyers and doctors, why not state legislation to allow *everyone* to "incorporate"?⁵⁴ Without wishing to draft a model statute, I can envision state legislation permitting any employee to organize his own corporation to furnish whatever services his training, experience, or inclination suit him to perform, the corporation being empowered to contract with any person or firm to supply the services of its sole shareholder. The legislation would preserve the pre-existing employer-employee relationship in order to carry forward all social legislation enacted for the benefit of employees, and the newly-authorized "proletarian corporations" would be empowered, notwithstanding the antitrust laws, to organize into unions to carry on collective bargaining. In all other respects, the corporations would have, or would purport to have, the "corporate characteristics" of limited liability, continuity of life, centralized management, and transferability of shares.

I do not want to expand this article to comment on the proper treatment of the "proletarian corporation," but I should like to predict that we will soon be holding tax institutes on this subject if the professional corporation is recognized for federal tax purposes. It behooves us, therefore, to approach the professional corporation

⁵⁴ For an analogy, see Blum, *How to Get All (but all) the Tax Advantages of Dabbling in Oil*, 31 TAXES 343 (1953), suggesting that percentage depletion be extended to all income.

with a lively recognition of the fact that doctors and lawyers are not the only persons who are not covered by qualified pension and profit-sharing plans ⁵⁵ and who cannot help themselves by incorporating under general corporation laws.

⁵⁵ I have emphasized the lure of qualified pension and profit-sharing plans, but employees would probably not be repelled by deferred compensation plans, excludible sick pay and death benefits, income-splitting, and other opportunities that are open to the man with a corporation.

APPENDIX

THE GEORGIA PROFESSIONAL ASSOCIATION ACT

Section 1. This Act may be cited as "The Georgia Professional Association Act."

Section 2. Definitions.

(a) "Professional Service" means any type of professional service which may be legally performed only pursuant to a license from a State Examining Board pursuant to the provisions of Ga. Code Title 84, for example, the personal services rendered by attorneys at law, certified public accountants, chiropractors, dentists, osteopaths, physicians and surgeons, and podiatrists (chiropodists).

(b) "Professional Association" means an unincorporated association, as distinguished from a partnership, organized under this Act for the purpose of rendering one type of professional service.

Section 3. Any two or more persons duly licensed to practice a profession under the laws of this State may form a professional association, as distinguished from a partnership and a corporation, by associating themselves for the purpose of carrying on a profession and dividing the gains therefrom upon compliance with the terms of this Act; provided that no professional association organized pursuant to the provisions of this Act shall render professional service in more than one type of professional service.

Section 4. Such persons may form a professional association by executing and recording Articles of Association in the Office of the Clerk of the Superior Court in the county in which the association's principal office is located. The Clerk shall record such Articles of Association and any amendments thereto or instruments of dissolution thereof in a separate book to be kept for that purpose, and shall receive as fees for recording any original Articles of Association or amendments thereto the sum of Five Dollars (\$5.00) plus Fifteen Cents (15¢) for each one hundred words contained in the particular document recorded. Such Articles of Association shall not be required to be published or recorded elsewhere. Such record of said Articles of Association, when so recorded, shall be notice of the provisions of the Articles to the world as well as to all parties dealing with such Association. Such persons shall adopt such name for the Association as they in their discretion may determine. Provided, that the name selected shall be followed by the words "Professional Association" or the abbreviation "P.A." Said Articles of Association may contain any provision not in violation of law or the public policy of this State as the members of the association may decide. Such Articles may be amended or dissolved at any time and from time to time by agreement of two-thirds of the members at any regular meeting or at a special meeting called for that purpose, and upon likewise recording such amendment or instrument of dissolution in the same place or places as the original Articles of Association.

Section 5. A professional association may be organized only for the purpose of rendering one specific kind of professional service and shall not engage in any business other than rendering the professional service for which it was organized. However, it may invest its funds in real estate, mortgages, stocks, bonds, or any other type of investment, and may own real or personal property necessary or appropriate for rendering its professional service.

Section 6. A professional association may render professional service only through officers, employees, and agents who are themselves duly licensed or otherwise legally authorized to render professional service within this State. The term "employee" as used in this Section does not include clerks, bookkeepers, technicians, nurses, or other individuals who are not usually and ordinarily considered by custom and practice to be rendering professional services for which a license or other legal authorization is required in connection with the profession practiced by a particular professional association, nor does the term "employee" include any other person who performs all his employment under the direct supervision and control of an officer, agent, or employee who is himself rendering professional service to the public on behalf of the professional association; provided that, no person shall, under the guise of employment, practice a profession unless duly licensed to practice that profession under the laws of this State.

Section 7. This Act does not modify any law applicable to the relationship between a person furnishing professional service and a person receiving such service, including liability arising out of such professional service, and including the confidential relationship between the person rendering the professional service and the person receiving such professional service, if any, and all confidential relationships previously enjoyed under the laws of this State or hereinafter enacted shall remain inviolate. Subject to the foregoing provisions of this Section, the members or shareholders of any professional association organized pursuant to the provisions of this Act shall not be individually liable for the debts of, or claims against, the professional association unless such member or shareholder has personally participated in the transaction for which the debt or claim is made or out of which it arises.

Section 8. A professional association organized pursuant to the provisions of this Act shall be governed by a Board of Governors elected by the members or shareholders, and represented by officers elected by the Board of Governors, so that centralization of management will be assured, and no member shall have the power to bind the association within the scope of the association's business or profession merely by virtue of his being a member or shareholder of the association. Members of the Board of Governors need not be members or shareholders of the professional association and officers need not be members of the Board of Governors except that the President shall be a member of the Board of Governors, provided that no officer or member of the Board of Governors who is not duly licensed to practice the profession for which the professional association was organized shall participate in any decisions constituting the practice of said profession. The members may adopt such by-laws as they may deem proper, or the power to promulgate by-laws

of the association may be delegated by the Articles of Association to the Board of Governors of the professional association, as the members or shareholders may decide. Each member or shareholder shall have such power to cast such vote or votes at the meeting of the members or shareholders as the Articles of Association shall provide. The officers of the professional association may employ such agents or employees of the association as they may deem advisable subject to the provisions of Section 6 above. The officers of the association shall include a President, Vice President, Secretary, Treasurer, and such other officers as the Board of Governors may determine. Any one person may serve in more than one office provided that the President and the Secretary of the professional association shall not be the same person.

Section 9. Unless the Articles of Association expressly provide otherwise, a professional association shall continue as a separate entity independent of its members or shareholders, for all purposes for such period of time as provided in the Articles, or until dissolved by a vote of two-thirds of the members, and shall continue notwithstanding the death, insanity, incompetency, conviction for felony, resignation, withdrawal, transfer of membership or ownership of shares, retirement, or expulsion of any one or more of the members or shareholders, the admission of or transfer of membership or shares to any new member or members or shareholder or shareholders, or the happening of any other event, which under the law of this State and under like circumstances, would work a dissolution of a partnership, it being the aim and intention of this Section that such professional association shall have continuity of life independent of the life or status of its members or shareholders. No member or shareholder of a professional association shall have the power to dissolve the association by his independent act of any kind.

Section 10. A professional association organized pursuant to the provisions of this Act may issue stock or certificates of evidence of ownership of an interest in the assets of the professional association to the members of a stock-type association, or the association may be a non-stock organization with the members owning no individual interest in the assets of the association but with the rights and duties specified in the Articles of Association, or the association may be a non-stock organization with the members owning undivided interests in the assets of the association according to the Articles of Association. The stock or certificates of ownership, if a stock-type association, or a membership in a non-stock association, shall be freely transferable except as may be lawfully restricted in the Articles of Association. A professional association may issue its capital stock if it is a stock-type association or accept as members of the professional association, if a non-stock association, only persons who are duly licensed or otherwise legally authorized to render the same professional service as that for which the professional association was organized. Subject to the provisions of the Articles of Association, the estate of a member or shareholder who was a person duly licensed or otherwise legally authorized to render the same professional service as that for which the professional association was organized may continue to hold stock or membership pursuant to the Articles of Association for a reasonable period

of administration of the estate, but shall not be authorized to participate in any decisions concerning the rendering of professional service.

Section 11. If any member, shareholder, agent, or employee of a professional association becomes legally disqualified to render a professional service within this State, or accepts employment or is elected to a public office that pursuant to existing law is a restriction or limitation upon rendering of professional service, he shall sever all employment with, or financial interest in, such professional association forthwith. A professional association's failure to comply or require compliance with this provision shall be a ground for the forfeiture of its right to render professional service as a professional association pursuant to the provisions of this Act. When a professional association's failure to comply with this provision is brought to the attention of the Secretary of State, the Secretary of State shall certify that fact to the Attorney General for appropriate action to dissolve the professional association.

Section 12. If the Articles of Association or by-laws of a professional association fail to fix a price at which a professional association or its members or shareholders may purchase the membership or shares of a deceased, retired, expelled, or disqualified member or shareholder, and if the Articles of Association or by-laws do not otherwise provide, then the price for such share or shares or membership shall be the book value of such share or shares or membership at the end of the month immediately preceding the death of or disqualification of the member or shareholder. Book value shall be determined by an independent certified public accountant employed for such purpose from the books and records of the professional association by the regular method of accounting employed by the professional association. The determination by the certified public accountant of book value shall be conclusive on the professional association and its members or shareholders.

Section 13. A professional association shall, within 30 days after the organization of the professional association pursuant to the provisions of this Act and within 30 days after the first day of November in each year thereafter, furnish a statement to the Secretary of State showing the names and post office addresses of all members or shareholders in such professional association and shall certify that all members or shareholders are duly licensed or otherwise legally authorized to render professional service in this State. This report shall be made on such form and shall be prescribed and furnished by the Secretary of State, shall be signed by the President or Vice President of the professional association, and acknowledged and sworn to before a notary public by the person signing the report, and shall be filed in the office of the Secretary of State, together with a filing fee in the amount of One Dollar (\$1.00). Upon the failure or refusal of any professional association to make said return or report to the Secretary of State, the professional association shall be liable for a penalty of Fifty Dollars (\$50.00), and the Secretary of State is authorized to issue his execution therefor, including all costs incurred.

Section 14. A member or shareholder of a professional association may sell or transfer his membership or shares in such professional association

only to another individual who is duly licensed or otherwise legally authorized to render the same professional services as that for which the association was organized.

Section 15. In the event of dissolution of a stock-type professional association, the Board of Governors, as trustees of the property of such professional association, shall apply the assets first to the payment of debts of the association, and secondly, to the holders of the stock as provided in the Articles of Association. In the event of dissolution of a non-stock type association, the assets shall be distributed, or sold, and the net proceeds distributed first to the payment of debts of the association, and secondly, to or among the members of the association as the Articles of Association shall provide.

Section 16. A professional association organized pursuant to the provisions of this Act may contract in its own name, take, hold, and sell real and personal property in its own name, independent of its members, sue and be sued as independent entities as now provided by law. Any conveyance in the name of the professional association to a third person executed by the President and attested by the Secretary shall be conclusively presumed to be properly executed and shall divest all right, title, and interest of the professional association, its members, and the Board of Governors thereof. The assets of a professional association shall not be liable to attachment for the individual debts of its members or shareholders.

Section 17. The law entitled "Actions by or against Unincorporated Organizations or Associations," approved February 13, 1959 (Ga. L. 1959, pp. 44-46, and published in the Code of Ga. Ann. as Sections 3-117 to 3-121, inclusive) * is incorporated herein by reference and shall govern such professional associations organized pursuant to the provisions of this Act in all respects as contained therein.

Section 18. Such professional association organized pursuant to the provisions of this Act shall be governed generally by all laws governing or applicable to corporations, where applicable, and not in conflict herewith, and no such association shall be held or deemed to be a partnership nor shall such association be governed by laws relating to partnerships.

Section 19. Should any provision of this Act be held illegal or unconstitutional, the same shall not vitiate the remaining provisions of this Act, but all such provisions not held illegal or unconstitutional shall remain in full force and effect.

Section 20. All laws and parts of laws in conflict with this Act are hereby repealed.

* These provisions permit suits by and against unincorporated associations to be brought in the firm name. [Ed.]