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IS THE COMMISSIONER'S AUTHORITY EXCEEDED IN THE PROPOSED REGULATIONS FOR PROFESSIONAL FIRMS?

LOUIS MAIER* AND ROCHE CARTER**

Practice under annotated statutes may have dulled lawyers' perception of their historical role in the development of the law. It is easy to forget that the great principles of common law were developed from the opposing contentions of lawyers in presenting their clients' cases to judges for determination. The growth of such a large body of statutory law has eliminated to a large extent the active part of the lawyer in the development of new legal principles not involved in the construction of statutes. Consequently, lawyers tend to take a more passive role in the law-making process. We accept the statutes as they are passed and only occasionally question their constitutionality. This is evident in the attitude of many attorneys to the proposed regulations under section 7701 of the Internal Revenue Code of 1954 relating to professional corporations and associations, their reactions being outrage rather than attempts to get judicial correction thereof.¹

For example, in Commerce Clearing House's Pension Plan Guide it is stated:

In a statement from the American Bar Association it was noted that the Association is actively engaged in activities to bring about tax treatment for retirement plans of professional people which is similar to that offered to corporate employees under a qualified plan. The statement said that the question of professional corporation is one for individual states and the ABA has taken no official position with regard to them. Also, the Association has taken no official position with regard to the proposed regulations under Section 7701(a), but the statement said that 'the proposed Internal Revenue Service regulations would make it virtually impossible for professional corporations to qualify as a corporation for Federal tax purposes.'² (Emphasis added.)

The thesis of this paper is that it is not the regulations that determine the tax status of any organization. As so pointedly stated several years ago by John Connolly, former secretary and general counsel for

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¹ CCH 1964 STAND. FED. TAX REP. ¶ 8872-73.
Minnesota Mining and Manufacturing Company, in an income tax class, "the regulations are only the Commissioner's opinion of what the law is." Too many of us accept the regulations without question. In a way, this is an acknowledgement of the good job which the Commissioner of Internal Revenue has generally done; however, this does not mean that he is correct here. In fact, the long time between announcement of their planning and their publication could indicate a strong internal division of opinion on the subject among the Commissioner's staff. Very likely, the opinions of various staff members can be represented by several different viewpoints.

Undoubtedly, several of the staff agree with the position set out by Professor Boris I. Bittker in his article, "Professional Associations and Federal Income Taxation: Some Questions and Comments." In that article, Professor Bittker is frank to indicate his bias in favor of national action rather than state action. He expresses a fear of state activity that is parallel to the "1942-1948 Community Property Syndrome," where several states enacted community property laws to achieve tax equality with the community property states.

Others may object to the new form of professional organization, largely on traditional grounds. For example, many attorneys have expressed the opinion, based on ethical grounds, that no law firm should be allowed to incorporate.

However, these differing opinions are not really the issue. The issue is: Are the proposed regulations in conformity with the Internal Revenue Code and the court decisions under it?

**Provisions of the Proposed Regulations in Respect to Professional Corporations**

The proposed amendments to the regulations deal with the classification of associations for tax purposes. They set forth specific standards that must be met in order that professional service organizations will receive corporate tax treatment from the Commissioner. They define a professional service organization as "an organization formed by one or more persons to engage in a business involving the performance of professional services for profit which, under local law, may not be organized and operated in the form of an ordinary business corporation having all the usual characteristics of such corporation." This definition is used regardless of the denomination of the organization under applicable state law. The proposed regulations justify this special consideration of the professional service corporation on the alleged inherent difference between such a corporation and the familiar type of business corporation when viewed from the standpoint of the rela-

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4 Proposed Treas. Reg. § 301.7701-2(h) (1) (i).
tionships of the members of the organization to each other and of the members to clients or patients and to the public.\(^5\)

In order for a professional service organization to receive corporate tax treatment, it must be found to possess certain characteristics of the ordinary business corporation. The proposed rules for determining when an organization has the characteristics of continuity of life, centralization of management, limited liability, and free transferability of interest are set out.\(^6\) These differ considerably from the concepts defined in the "old" Kintner regulations.

**Continuity of Life.** The proposed regulations deny continuity of life where a member's right to share in the profits is contingent upon being actively employed in the production of income. They further state that the required sale of ownership interest upon termination of the employment relationship also indicates lack of continuity of life.\(^7\) These are novel concepts in the fields of corporate and tax law. If these ideas were applied to any corporation where capital was not a material income producing factor, a very great number of small corporations whose corporate status has, up to now, never been questioned would fail to meet the test. The Commissioner's proposed regulations attempt to make a distinction between characteristics imposed by agreement of the parties and characteristics imposed by statute. Laymen will have a hard time appreciating the difference, especially after an ambitious revenue agent starts questioning a corporation's corporate tax status on this ground. The regulation's statement that this type of continuity of existence is essentially different from the continuity of existence of an ordinary business corporation is not consistent with actual situations that exist in a great many instances. Very frequently, lawyers are called upon to draft, for small "ordinary business" corporations, agreements that provide for stock repurchase upon termination of employment. Could it be that the only experience in this field on the part of some of the young men on the Commissioner's staff has been with the large corporations whose problems are frequently dealt with in the case books which only touch upon the practices followed in the cases of the many small closely owned corporations?

**Centralized Management.** Here the proposed regulations\(^8\) require that the managers have exclusive authority to do all of the following: retain and discharge members and employees; determine salaries and other conditions of employment; select those to whom services will be rendered; assign cases or matters to members and employees; set the procedure for each case; establish fees to be charged; determine nature, use, and disposition of the organization's records; and authorize

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\(^5\) Proposed Treas. Reg. § 301.7701-2 (h) (1) (ii).

\(^6\) Proposed Treas. Reg. § 301.7701-2.

\(^7\) Proposed Treas. Reg. § 301.7701-2 (h) (2).

\(^8\) Proposed Treas. Reg. § 301.7701-2 (h) (3).
distribution of earnings. With the exception of the last, these are similar to the usual attributes of corporations. The authorization for distribution of earnings in all corporations is made by the directors as such, and not by the managers as such. There is a real difference between the two capacities. As a matter of practice, there is just about the same amount and kind of centralized management in partnerships with more than two bona-fide partners as there is in small closely owned corporations. A more accurate statement of the rule is made in the private ruling given to the Old Colony Medical Group of Meridian, Connecticut in 1961. There, the Commissioner did find sufficient corporate characteristics and an employment relationship such as to cause the corporation to be taxed as a corporation and be required to withhold taxes on wages of shareholder employees.

Limited Liability. The proposed regulation's statement that the professional service organization does not possess the characteristic of limited liability if the members' personal liability is greater than a shareholder-employee of an "ordinary business" corporation is confusing at best. By inference it seems to preclude the forms of liability that attached to shareholders of many "ordinary business" corporations, such as double liability in the case of banks and for wages earned within a limited period before termination of business.

Free Transferability of Interests. The proposed regulations state that the characteristic of free transferability of interest is not present in the typical professional organizations, since the right of the member to share profits of the organization is contingent upon the existence of an employment relationship. The proposed regulation distinguishes the right of first refusal in connection with the transfer of an interest in an "ordinary business" corporation where such right applies only to the profits and assets of the enterprise, from the professional service organization where it applies as well to the right to the employment relationship. They contend that in a professional organization the right to share profits is contingent upon continuing employment. These are mere words, as there is hardly a small corporation where profits are distributed other than as a part of compensation.

Proposed Regulations Go Beyond Existing Case Law

The validity of the proposed additions to the regulations must be tested in the light of their conformity to existing law. In this testing, the doctrine of congressional acquiescence must be considered. It is an
established rule that if Congress reenacts a statute without substantial change, there is a sound indication that previous judicial interpretations of the statute are approved by Congress. Consequently, the proposed regulations must be examined for conformity with judicial interpretations.

There are actually two types of regulations: legislative and interpretive. Legislative regulations are made pursuant to a specific delegation of legislative power which set out the standards to be applied in drafting the regulations. Here, we are concerned rather with interpretive regulations. If the Treasury's interpretation of the statute has received legislative approval, its interpretation has become fixed in the statute and the Treasury should have no more power to change the regulation than to change the wording of the statute itself. Therefore, since section 7701(a)(3) of the 1954 Code is identical with section 3797(a)(3) of the 1939 Code, the Treasury has no authority to change the regulations. It is our contention that the proposed regulations do attempt to change the law, and that where this is attempted they are invalid.

The best way to determine the validity of the newly proposed regulations is to test them against the law: statutory, court decisions, and the old regulations which have the authority of implied adoption by Congress.

The statute under both the 1954 and 1939 Internal Revenue Codes is identical except for section numbering. The court decisions have been reviewed so many times that another summary hardly seems necessary. However, the Commissioner's proposed regulations are so much at variance with the court decisions that a further examination of the fundamental cases is necessary.

**Judicial Construction of the Statute**

The United States Supreme Court has set out the principal characteristics that determine whether or not an organization is taxable as a corporation in *Morrissey v. Commissioner*. In this case, the individuals involved entered into a declaration of trust and transferred certain real estate to the trustees. The trustees sold some of this land and improved the remainder by development of a golf course. This was sold to Western National Golf Club, Inc., in exchange for its stock. Thereafter, the trustees confined their activities primarily to the collection of moneys due and the making of distributions to beneficiaries. Under the trust agreement, the trustees have the power of sale, to make investments, and generally to manage the trust estate. They could

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choose their own successors and add to their number. Beneficial interest in the trust was evidenced by transferable certificates, but the certificate holders' votes were advisory only. The trustees had no power to bind the beneficiaries personally by any act, neglect, or default, and the death of a beneficiary or a trustee did not end the trust.

The trustees claimed that this organization was a trust taxable under section 219 of the 1924 and 1926 Revenue Acts, principally because the beneficiaries had no voice in the management, or control over the trustees. In view of the Commissioner's position of attempting to deny corporate status to professional service organizations in the proposed regulations, it is ironic to note that here it was the Commissioner who was asserting that the organization must be taxed as a corporation. It can be explained that the Commissioner is perfectly consistent in both cases. His sole aim in both actions appears to favor the increase in revenue regardless of whether the application of legal principles is consistent.

The United States Supreme Court upheld the Commissioner in Morrissey. Consequently, it is most difficult to understand how the Court could uphold the proposed regulations without overruling Morrissey. Simple justice and sound public policy of comparable equal treatment of taxpayers similarly situated should dictate that the Court uphold its previous position. The Court held in Morrissey that the trust had enough corporate characteristics to be taxable as such. The opinion pointed out that the beneficiaries had planned a common effort and entered into a combination for the conduct of a business enterprise. Consequently, it was distinguishable from an ordinary trust.

In its opinion, the Court set out the principal characteristics of a corporation, which, if present in an organization, would be sufficient to require that it be taxed as a corporation. These may be summarized as follows:

1. Associates.
2. Purpose of entering into a joint enterprise for transacting business.
3. Title to property held in the name of the entity and not the beneficiaries as individuals.
4. Centralized management.
5. Continuity of life irrespective of continuing membership or ownership by owners.
7. Transferability of interests without affecting continuity of life of the enterprise.

The problem does not come from failure to recognize these characteristics on the Commissioner's part. He has included all but the title characteristic in his regulations issued under the 1939 Code as well as

16 Id. at 359-60.
under the 1954 Code—the popularly designated *Kintner* regulations. The difficulty arises from the Commissioner's application and detailed interpretation of these principles.

In *Morrissey* and its companion cases, the Court pointed out that certain features usually found in corporations are not essential to a determination that an organization is an association taxable as a corporation. Thus, it is not necessary for the holders of the beneficial interests to have control over the operation of the business, as it is in the case of a corporation. Furthermore, the absence of particular corporate forms or of the usual terminology of the corporations is not determinative. In the three companion cases, the Court pointed out other features which would not be necessary, such as: operations may be limited to one project, as a single oil lease or an apartment house; no meetings need be held or records kept; the organization need not have an office, by-laws, or seal; and the number of beneficiaries may be small.

**Court Cases Since Morrissey**

Although the Commissioner has spent much recent effort drafting regulations which, if upheld by the courts, might deny corporate tax status to professional organizations, he has for many years been successfully enforcing corporate tax status against reluctant taxpayers in many other cases. Apparently, his left arm does not know what his right arm is doing. It is easy to understand that with a staff such as he has, members of one section do not have much communication with or influence on members of another section.

In 1938, the Commissioner was upheld in claiming corporate tax status in *Thrash Lease Trust v. Commissioner*, where the taxpayers claimed that they had an ordinary trust holding an oil and gas lease. There, transferable percentage interests were sold to many persons. The trust's business was personally conducted by the trustee's father, while the drilling operations were conducted by the trustee. There were no meetings of interest holders, no by-laws, no officers, and no written agreement defining the rights and interests of parties; nor were the interest holders expected to be liable for obligations other than the costs of drilling a second well. The Court held that the organization's general structure and method of operation were sufficiently analogous to a corporate organization to justify the Commissioner in taxing its income as that of a corporation.

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24 99 F. 2d 925 (9th Cir. 1938).
In 1940 the United States Court of Appeals for the Ninth Circuit, in *Kettleman Hills Royalty Syndicate No. 1 v. Commissioner*, found corporate tax status under similar facts, saying: "It is our opinion that in making these successive decisions whether it will require the delivery of the royalty product in kind or in cash, the taxpayer is making a succession of business judgments and 'is doing business' within the decision of Morrissey v. Commissioner, . . . though through the tax years in question it thought it better business to accept cash rather than the oil products."\(^{25}\)

In 1942, another trust was held taxable as a corporation in *Porter v. Commissioner*\(^ {26}\) on similar facts.

The Ninth Circuit dealt with still another trust arrangement in *Helm & Smith Syndicate v. Commissioner*\(^ {27}\) in 1943. In its opinion, the court held that limitation of a beneficiary's liability is not a *sine qua non* of corporate tax status:

In the first period we have an association of investors with a management by a committee of five persons acting as do a board of directors, with provision for continuing of the directing body as in corporations. The committee's function was not one of mere conversation of assets but of the usual leasing, selling and managing of petroleum properties of any of the oil owning and leasing corporations. As with stockholders there was a provision for the transfer of the beneficial interests in the continuing associative enterprise.\(^ {28}\)

In *Fletcher v. Clark*\(^ {29}\) the Tenth Circuit examined another trust. The organization did not mine or own mining equipment. It did not have by-laws, seal, minutes, officers, employees, or meetings of owners of beneficial interests. Nor did the trust agreement provide for limitation of personal liability. The court reviewed the usual criteria of corporate status as laid down in *Morrissey* and stated that each of these indices were not an unyielding rule of thumb. "Each case must be decided by reference to its own peculiar facts, particularly whether the undertaking bears a fair resemblance to corporations."\(^ {30}\)

There were similar facts and a similar holding in *Nee v. Main Street Bank*.\(^ {31}\) There the Eighth Circuit found the resemblance to corporations supportive, but not in invariable form. "It implies merely the existence of characteristics in its written structure or in its adopted mode

\(^{25}\) 116 F. 2d 382 (9th Cir. 1940).
\(^{26}\) Id. at 383.
\(^{27}\) 130 F. 2d 276 (9th Cir. 1942).
\(^{28}\) 136 F. 2d 440 (9th Cir. 1943).
\(^{29}\) Id. at 441.
\(^{30}\) 150 F. 2d 239 (10th Cir.), cert. denied, 326 U.S. 763, rehearing denied, 326 U.S. 809 (1945), 166 A.L.R. 1456.
\(^{31}\) Id. at 240.
\(^{32}\) 174 F. 2d 425 (8th Cir. 1949).
of operation that remind patterningly of a corporate organization, though not identical therewith."

The Sixth Circuit reached the same result with a trust holding a real estate lease in *Main Hammond Land Trust Co. v. Commissioner.* Here the court deemed the business purpose for which the trust was organized of great significance. Another important factor was the transferability of beneficial interests.

The Tax Court threw a considerable amount of light on the subject in *John Province #1 Well,* upholding the Commissioner's determination that the taxpayers who owned fractional interests in the rights to profits from certain gas wells were associations taxable as corporations. In this case, the grounds for the decisions were as follows: An organization need not be identical with a corporation to be so taxed, but need only resemble a corporation. The taxpayers had a common purpose to carry on a business for profit, and the assignees constituted associates. Centralized management existed because the assignor reserved to himself all managerial functions. Continuity of existence was present, since the record discloses that death and transfers occurred without demonstrable effect. Centralization of legal title and limited liability might not be present in the strict sense. However, the powers retained by the assignor were the equivalent of absolute ownership, and it is apparent that there was a purpose to limit the liability of the investors to the amount originally contributed to the enterprise. There was a provision in the agreement that no partnership was intended, and this was regarded as an attempt to limit liability.

The Third Circuit affirmed this tax court decision, pointing out in its opinion that the interests were specifically designated as tenancies in common and not as a partnership. There were inter vivos transfers of fractional interest from time to time without interrupting the business or necessitating any reorganization. There was no identification by name, telephone listing, officers, or articles of association beyond the assignee-manager's records of allocations of costs and income.

*The Medical Clinic Cases*

These cases have been so often referred to that one fears that to review them again would be mere redundancy. However, since the Commissioner's proposed regulations are inconsistent with them, another review is necessary to indicate that this is so. The most celebrated case is *Kintner v. United States,* decided by the Ninth Circuit in 1954.

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33 *Id.* at 431.
34 200 F. 2d 308 (6th Cir. 1952).
36 *John Provence #1 Well v. Commissioner,* 321 F. 2d 840 (3d Cir. 1963).
37 216 F. 2d 418 (9th Cir. 1954).
In *Kintner*, a group of doctors dissolved their partnership and transferred its assets to the "Western Montana Clinic," an association which was to continue until the death of the last survivor of the original members. The articles provided for both junior and senior members and that the business affairs were to be managed by an executive committee consisting of five men elected by the senior members. Membership was limited to physicians and surgeons licensed to practice medicine in the state of Montana. It was provided that only the members were to be liable to third parties for professional misconduct, and that any indebtedness incurred by the association through the act of a member, without approval of the executive committee, was chargeable to the member concerned. Furthermore, the articles provided that the death or retirement of a member would not result in dissolution of the association and that beneficial interests of members were non-assignable except by complying with restrictions. It was conceded by the court that the personal liability features more closely resembled a partnership than a corporation. In its decision, the court concluded that the organization more closely resembled a corporation than a partnership and that it should be taxed as a corporation. It stated that not all of the tests stated in the *Morrissey* decisions must be met in each instance.

In 1936, the Seventh Circuit held in *Pelton v. Commissioner* that a business trust entered into by a group of Illinois doctors was taxable as a corporation. The doctors transferred certain equipment to themselves as trustees and issued beneficial interest certificates which represented transferable shares subject to options to purchase given to other beneficiaries before they could be sold to outsiders. The beneficiaries were given the power to fill vacancies among the trustees. Upon the death of a beneficiary, his beneficial interest passed to his wife or other relative subject, however, to the repurchase option by the trustees or other beneficiaries. The trust was to last for ten years, after which all assets would be distributed to the beneficiaries.

A district court in Texas found the "Southwest Medical Clinic Association" taxable as a corporation in *Galt v. United States* where the facts were very similar to *Pelton*. However, in *Galt*, upon retiring, an associate would receive one year's salary, apparently in lieu of his capital interest.

The most recent case is *Foreman v. United States*, decided April 2, 1964. Here two doctors who had been partners formed an association on June 1, 1960. On October 11, 1960, a third doctor was employed under an agreement which set out the usual conditions of employment. On the same day, the doctors entered into a separate agreement whereby

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38 82 F. 2d 473 (7th Cir. 1936).
the two members of the association agreed to transfer a portion of their respective ownership interests to the newly employed doctor annually during his employment so that after five years he would become a one-third owner.

The association had articles of association which provided for perpetual existence, voting by members in proportion to percentage of ownership, annual meetings, and a board of governors to manage its business and affairs.

Upon death or retirement, neither the associate nor his personal representative had any interest in or right to withdraw any portion of the assets. However, the associates or his personal representative could transfer his ownership interest provided that the association and other associates had first option to buy such interest.

The articles of association further provided that it would not be dissolved by death, resignation, insolvency, bankruptcy, removal, or retirement of an associate. Assets of the partnership amounting to $209,000 (the bulk of which constituted accounts receivable) were transferred to the association, apparently in a non-taxable exchange under section 351 of the Internal Revenue Code of 1954.

The Government contended that since physicians cannot legally form a corporation for the practice of medicine in Florida, the association, regardless of how many tests it might meet, could never have the requisite substantial resemblance to a corporation required under the federal statute. Judge Choate pointed out that this argument was made by the Government in the *Kintner* and *Galt* cases, and also in the *Pelton* case, and was rejected by the court in each.

The Government also contended that a medical association largely obtains its income from personal services and thus does not earn the kind of income normally earned by a corporation. This contention is similar to the reasoning in the proposed regulations. However, it did not impress the court, which said in respect thereto:

> The fallacy of this argument is readily apparent when one considers the large number of corporations presently existing in our economy whose primary income is earned solely from the personal services of their employees. The corporate tax status of businesses engaged in advertising or promotion, investigation, sales, contract janitorial or secretarial service, to name a few, has not been seriously questioned to the Court's knowledge.\(^4\)

The court concluded that on the established precedents, judgment must be rendered finding corporate tax status for tax purposes. The case did not discuss the *Kintner* regulations or the proposed additions.

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\(^4\) *Id.* at 137.
Conclusions

From these cases we can rather positively determine the characteristics that make an organization taxable as a corporation. These are:

1. Separate entity. This probably is a result of other characteristics; nevertheless, either a professional service corporation or a trust does constitute an entity separate from its members. We believe that a professional association also has this characteristic even though it does not get a charter from a governmental body.

2. Purpose to carry on a business for profit. The new regulations, either proposed or adopted, do not seem to raise any problem here.

3. Associates. If regarded as absolutely necessary, this would make it difficult for the one-man firms to qualify. However, there are very many one-shareholder, "ordinary business" corporations, even in service industries. We doubt that this attribute should always be insisted upon because, after all, a partner always has associates. No question as to the number of members was raised in the Foreman case, as the association started out with two associates and then added a third a few months later.

4. Title to property held in the name of the entity.

5. General structure and method of operation substantially resembling that of a corporation. The Morrissey decisions set out the characteristics which generally indicate substantial resemblance:

a. Centralized management. This involves some sort of a board of directors, board of governors, or board of trustees, who set general policy that is carried out by officers. This does not mean that the directors must concern themselves with details of operation such as the treatment of individual patients by individual doctors.

b. Continuity of life. This requires that the existence of the entity is not affected by the death, resignation, insolvency, bankruptcy, or retirement of an owner. The fact that there are agreements providing for repurchase of such an individual's equity upon the occurrence of such an event does not affect the continuity of the entity.

c. Transferability of interests. This is more or less the other side of continuity of life. However, if the organization structure is not affected by the transfer of an equity interest, the fact that such transfers are subject to options to repurchase by the organization or other equity owners should not affect the tax status of the organization. This procedure is followed almost as a matter of course in respect to most small close corporations.

d. Limited liability. This is a corporate characteristic that has been restricted in cases of some "ordinary business" corporations. The fact that the limitation on personal liability is only partial

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42 See cases cited notes 15 and 19 supra.
should not cause the organization to be taxed other than as a corporation.\textsuperscript{44}

The court decisions delineate many features and practices which are seldom considered characteristic of corporations but which, if present, do not prevent taxation of the organization as a corporation. These include: limitation of operations to one project such as a single oil lease or an apartment house; failure to hold meetings or keep records; lack of an office, by-laws, or seal; and a small number of beneficiaries.\textsuperscript{45}

\textit{Prognosis}

This might best be designated as "sticking out one's neck." Nevertheless a client is entitled to have his attorney-advisor indicate to him what the attorney's informed opinion is as to how the law will develop. Consequently, we are setting down our opinion of what we think clients can expect:

1. The \textit{Foreman} case is entirely consistent with prior decisions. We believe that future decisions will continue along the same line.

2. We believe that it will be easier to convince a court that the proposed regulations in their original form are invalid, than it would be if they were modified to come closer to the law. Only a slight departure from court decisions might be rationalized as a reasonable interpretation of the court's opinion. Radical departures are much easier to recognize and for the courts to overturn.

3. Since there are many clients and their attorneys who do not wish to depend upon litigation to establish their tax status as corporations, statutory relief is desirable. This has been initiated and has resulted in the introduction of two bills\textsuperscript{46} into Congress which would amend section 7701(3) of the Internal Revenue Code of 1954 to include "professional associations formed under state law" within the definition of organizations taxable as corporations. This amendment will not clarify the tax status of professional corporations except by indirection. It seems to us that more certainty could be obtained by including within the definition of corporations "any organization which receives a certificate of organization or charter from a state and which has existence separate from its members."

\textsuperscript{44} Wis. \textsc{Stat.} \S 180.40(6) provides that the shareholders of every corporation, other than railroad corporations, shall be personally liable to an amount equal to the issue value (par value in use of par value shares or consideration when issued as no par shares) of shares for debts owing employees for services performed for not more than six months. Section 200.06 provides that the Commissioner of Insurance can order an insurance corporation to restore its capital by assessments on its shareholders. It is apparent that in Wisconsin the "unlimited" liability of shareholders of "ordinary" business corporations is not in fact "unlimited."

\textsuperscript{45} See cases cited note 19 \textit{supra}.

4. The proposed regulations do suggest some points to consider in drafting articles of organization and where state statutes could be amended. For example, section 180.99(8) of the Wisconsin statutes provides that the legal relationships between a person receiving professional services and persons rendering such services who are shareholders, resulting in legal liabilities, shall be joint and several as is the case in partnerships. However, this does not apply to liability arising out of actions of employees who are not shareholders. This was included in the statute because the sponsors believed that it would make it easier for the legislature to accept the law. It might have been better to retain "ordinary" corporate liabilities and insist that the organization be required to carry a reasonable amount of professional liability insurance coverage.

A careful reading of the proposed regulations will be a helpful guide to the alert attorney. In drafting articles of organization, it would be well to exclude any provisions that spell out restrictions on transferability or ownership of the stock. The proposed regulations seem to make inclusions of such restrictions in the articles of organization an important factor in determining corporate tax status. Such corporate status is not denied where merely included in agreements adopted by the equity owners themselves, as is the case with so many small "ordinary" business corporations.17 Furthermore, one would be prudent to exclude any provisions which spell out what happens upon the death or termination of employment of shareholders, or what happens upon disqualification to hold stock, as when an attorney is elected to a judicial office. The same objective can be obtained by use of employment contracts and buy and sell agreements. The regulations apparently recognize a distinction in this respect.

5. Attorneys might well advise their clients to use the common law trust procedure such as is set out in section 226.14 of the Wisconsin statutes, rather than the professional corporation statute, section 180.99. Since the Wisconsin professional corporation law gives authority to practice the professions in the corporate form, no ethical problem should be encountered in the use of the common law trust. The advantage is that section 226.14 contains no restrictions on ownership or transferability in that statute itself. If these are incorporated only in employment agreements and buy and sell agreements rather than in the articles of organization, the entity should meet the requirements of the proposed regulations as well as existing law. Furthermore, Flecher's Corporation Service and Nichols Forms cite authority to the effect that if the governing trustees of a common law trust are not elected by the

17 Proposed Treas. Reg. § 301.7701-2 (b) (2).
equity owners, the limited liability of the equity owners will be recognized.

_The Challenge_

We believe that there is a responsibility on the part of attorneys to take an active part in the development of the law in this area. Passive acceptance of or failure to object to the Treasury's insistence of non-corporate tax status of these types of organizations permits legislation by bureaucracy. The Treasury's position is based on the grounds of "protecting the revenue." This is no substitute for substantially equal treatment of taxpayers in substantially similar situations. We need more attorneys who are willing to do their part in righting wrongs. Even the professional man, though well compensated, has the right to equitable treatment.