Case Western Reserve Law Review

Volume 12 | Issue 4

1961

# Taxability of Unincorporated Medical Associations--The Kintner Regulations

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# *Taxability of Unincorporated Medical Associations—The Kintner Regulations*

In recent years doctors and other professional groups have sought ways to obtain the "fringe benefits" that are normally accorded to "employees" under the Internal Revenue Code (hereafter referred to as the Code). Examples of these benefits are social security coverage,[1] group hospital and medical coverage, health and accident insurance,[2] exclusion of sick pay from gross income,[3] and most important, tax-exempt pension and profit-sharing plans.[4] Most self-employed persons can obtain these benefits by incorporating their businesses. However, statutes in most states prohibit professionals from carrying on their practices in the corporate form.[5]

Until recently many doctors have successfully gained some of these advantages, namely tax-exempt pension and profit-sharing plans, by banding together to form medical clinic associations. This has been possible, since the 1954 Code defines a corporation to include "*associations,* joint stock companies, and insurance companies."[6] These medical clinics have been classified as "associations" since they are organized in such a way as to closely resemble the corporate structure, and thus have achieved recognition as corporations for federal tax purposes. The member doctors have thus been classified as "employees," as is required to qualify for a tax-exempt pension plan.[7] Recently, however, the Commissioner has finalized his Regulations, known as the Kintner Regulations, under the 1954 Code in this area.[8] These Regulations, contrary to court authority and the previous Regulations under the 1939 Code,[9] in effect deny professional partnerships or individuals the opportunity to attain this privileged tax treatment, even though most non-professional taxpayers can obtain these benefits through incorporation, a method barred to professional groups. Much controversy and criticism has developed over the Kintner

1. Doctors of medicine are not covered by the Social Security Act, 64 Stat. 492 (1936), 42 U.S.C. § 411(c)(5) (1958).

2. Hospital, medical and health and accident premiums are excluded from the employee's gross income, if paid by the employer. INT. REV. CODE OF 1954, § 106.

3. INT. REV. CODE OF 1954, § 104.

4. INT. REV. CODE OF 1954, § 401.

5. OHIO REV. CODE § 1701.04. See also, 19 C.J.S. *Corporations* § 955 (1955); Ray, *Corporate Tax Treatment of Medical Clinics Organized as Associations,* 39 TAXES 73, 77 (1961); Note, 11 WEST. RES. L. REV. 616, 622 (1960). For comments on professional incorporation, see Lyon, *Action in Indiana on Kintner Type Organizations,* 39 TAXES 266, 271 (1961).

6. INT. REV. CODE OF 1954, § 7701(a)(3) (emphasis added).

7. United States v. Kintner, 216 F.2d 418 (9th Cir. 1954), Galt v. United States, 175 F. Supp. 360 (N.D. Texas 1959).

8. Treas. Reg. § 301.7701-1-11 (1960).

9. Treas. Reg. 118, § 39.3797-1-9 (1940).

Regulations. It has been argued that self-employed professionals, unlike most other groups, have received no preferential tax treatment, and have thus been classified by the Regulations as "second class" citizens.[10] This note will attempt to evaluate the effect of the new Kintner Regulations, apprise the tax planner of the difficulties created by the new Regulations, and suggest possible alternative courses of action.

## HISTORICAL DEVELOPMENT

The foundation for the classification of medical clinics as associations under the Code is the 1935 Supreme Court decision in *Morrissey v. Commissioner*.[11] The Court upheld the Commissioner's contention that an unincorporated business trust was taxable as a corporation. It stated that the inclusion of the word "association" within the definition of the word "corporation" implies resemblance and not identity. Further, although the presence of corporate forms may be persuasive, the absence of such forms is not decisive. Thus resemblance and not identity is controlling. The Court then set forth five characteristic features of a corporation as distinguished from a partnership. These features are (1) the transfer of beneficial interests without affecting the continuity of the enterprise, (2) a limitation of the personal liability of the participants, (3) a freedom from termination upon the death or withdrawal of a participant, (4) the opportunity for a centralized management through representatives of the participants, and (5) an ability to hold title to property used in the undertaking.[12] The Court declined to prescribe the minimum standard, but did indicate that the presence of all five characterstics would show a sufficient resemblance to enable an entity to be taxed as a corporation. In reaching its decision in the *Morrissey* case, the court refused to look at legal technicalities and made a determination of the tax classification based on the practical effect of both the state law and the partnership agreement. Thus, under the doctrine expounded in this case an organization could be taxed as a corporation, even though technically, under the local state law, it had not incorporated.

In 1936, in the case of *Pelton v. Commissioner*,[13] the Commissioner successfully applied the doctrine of the *Morrissey* case to a medical clinic organized as a trust. The Seventh Circuit Court of Appeals held that all the substantial points of resemblance to a corporation as specified by the Supreme Court in the *Morrissey* case were present.[14] Thus even though

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10. Jones, *Should Lawyers Incorporate*, 11 HASTINGS L.J. 150, 155 (1959).

11. 296 U.S. 344 (1935).

12. This last feature is no longer a distinguishing characteristic, since statutes in most states permit unincorporated entities to hold title to land and other property. UNIFORM PARTNERSHIP ACT § 8; OHIO REV. CODE § 1775.07.

13. 82 F.2d 473 (7th Cir. 1936).

14. Morrissey v. Commissioner, 296 U.S. 344 (1935), has been followed by courts holding

the Supreme Court of Illinois had just decided that a corporation could not practice medicine in that state, the court of appeals stated that the trust was an "association" and was therefore taxable as a corporation.

The Regulations under the 1939 Code embodied the doctrine of the *Morrissey* case that "local law is of no importance" in determining whether a business entity is to be regarded as an "association" for tax purposes.[15] Only two of the basic criteria set forth in the *Morrissey* case were included in the 1939 Regulations' definition of an association; the first of these was that the business of the entity must continue uninterrupted, notwithstanding the fact that its members may change, and the second was that the affairs of the business must be conducted by a single person or group of persons acting in a representative capacity.[16]

The present controversy was initiated by the decision of the Ninth Circuit in the celebrated case of *United States v. Kintner.*[17] Dr. Kintner and his associates established the Western Montana Clinic, an unincorporated association under the law of Montana. The structure of this association closely resembled that of a typical corporation. The association rented space, billed patients, collected fees, and paid salaries to its member doctors, paid social security and withholding taxes for its members, and established a pension plan for its members. The articles stipulated that death or withdrawal of a member would not dissolve the association, and that an executive committee would manage the business affairs of the association. But there were several non-corporate characteristics: under the articles, any liability of the association incurred without the authority of this committee was chargeable only to the member who incurred the liability, and the interests of the members were nonassignable.

The Commissioner charged Dr. Kintner with additional gross income of an amount equal to his credit in the pension trust, thereby denying corporate status to the association for tax purposes. The government contended that since a corporation is not allowed to practice medicine under local law, it cannot be classified as an association for tax purposes.[18] The court ruled against the Commissioner and, following the *Morrissey* and *Pelton* cases,[19] held that an association that more nearly

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that business trusts may be treated as associations for federal tax purposes, even though they are classified as partnerships or trusts under state law. These decisions have rested on the fact that local law is not controlling for federal tax purposes. Poplar Bluff Printing Co. v. Commissioner, 149 F.2d 1016 (8th Cir. 1945); Bert v. Helvering, 92 F.2d 491 (D.C. Cir. 1937).

15. Treas. Reg. 118, § 39.3797-1 (1940).

16. Treas. Reg. 118, § 39.3797-2 (1940).

17. 216 F.2d 418 (9th Cir. 1954).

18. It is interesting to note that in the *Morrissey* and *Pelton* cases it was the government that was arguing that local law was of no importance, and that resemblance not identity should be determinative.

19. See notes 11, 13 and 14 *supra.*

resembles a corporation than a partnership is a corporation for tax purposes.[20] It stated that to determine the nature of associations by local law would destroy the uniformity essential to the federal tax system. Equal treatment, said the court, must be accorded to all federal taxpayers, regardless of the laws of the state in which their business activities are carried on. To substantiate this viewpoint the court quoted the following language from a United States Supreme Court opinion in another tax case:

> The execution of that power [to tax income] is not subject to state control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nationwide scheme of taxation.[21]

Since in the *Kintner* case the interests of the members were non-assignable and at least some personal liability on the part of the members was possible, the court must have decided that the characteristics of continuity of life and centralized management were sufficient for association status.[22]

After the *Kintner* case the Commissioner stated his non-acquiescence in a revenue ruling in which he declared that he would not recognize the *Kintner* case; however, he declined to state what standards he would use in determining whether or not an entity is an association for tax purposes.[23] In another revenue ruling appearing a year later, in 1957, the Commissioner reversed himself by stating that he would use the "usual" tests (seemingly referring to the *Morrissey* doctrine or the 1939 Regulations) in determining whether an organization was an association for federal tax purposes.[24]

In the most recent case in this area, *Galt v. United States*,[25] a Texas District Court held on facts similar to those in the *Kintner* case that the medical association of which the plaintiff, Dr. Galt, was a member met all the requirements needed to incorporate an entity under the laws of Texas except that local law which prohibited the practice of medicine by

20. United States v. Kintner, note 7 *supra*. Hewitt in his article, *Associations Taxable as Corporations*, 47 A.B.A.J. 215 (1961) (hereafter cited as Hewitt), states that the court presumably referred to the Regulations under the 1939 Code (note 9 *supra*), and thus considered only continuity of life and centralized management.

21. Burnet v. Harmel, 287 U.S. 103, 110 (1932). The Supreme Court also stated in reference to this problem that "state law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law." *Id.* at 110. See also, Weiss v. Weiner, 279 U.S. 333, 337 (1929); United States v. Childs, 266 U.S. 304, 309 (1924).

22. See Hewitt, 215.

23. Rev. Rul. 56-23, 1956-1 CUM. BULL. 598.

24. Rev. Rul. 57-607, 1957-2 CUM. BULL. 887. For a brief discussion, see Hobbet, *Recent Developments in Tax Free Pension and Profit Sharing Benefits for Self Employed*, 33 WIS. BAR BULL. 35, 36 (June 1960).

25. Galt v. United States, 175 F. Supp. 360 (N.D. Tex. 1959).

a corporation. The court, which for some unaccountable reason failed to mention the *Kintner* case in its opinion, found no reason to deny the association the privilege of being treated as a corporation for tax purposes. Furthermore, the court stated that the act of a state in classifying business organizations under the laws of the state should neither raise nor lower the federal tax due from that organization.[26]

## THE REGULATIONS

In 1959 the proposed Regulations under section 7701 of the Code were issued.[27] These regulations are commonly termed the "Kintner Regulations," for it was generally believed that the Commissioner would follow his last revenue ruling[28] on this subject and base the regulations on the criteria used by the court in the *Kintner* case. However this was not the case, for the proposed regulations seemed to restrict the definition of the word association, especially in the professional organization area.[29] All doubt was dispelled, though, in November of 1960 with the issuance of the final Kintner regulations under section 7701. This final version, according to most tax authorities, strengthened the belief that the Commissioner intended to exclude all professional associations, especially medical clinics, from corporate tax status, regardless of their similarity to the corporate structure.[30] Various aspects of the problem of taxing such associations under the newly adopted Kintner Regulations will next be considered.

### *Effect of Local Law*

The final Regulations expressly state that the Internal Revenue Service (hereinafter referred to as the Service) will determine the classes into which different organizations will be placed for tax purposes.[31] Following that statement, however, the Commissioner indicates that local law will affect such a classification in the following manner:

> Although it is the Internal Revenue Code rather than local law which establishes the tests or standards which will be applied in determining the classification in which an organization belongs, local law governs in determining whether the legal relationships which have been established in the formation of an organization are such that the standards are met. Thus, it is local law which must be applied in determining such matters as the legal relationships of the members of the organization

26. *Ibid.*
27. Treas. Reg. § 301.7701-1-11 (1960).
28. Rev. Rul. 57-607, 1957-2 CUM. BULL. 887.
29. Proposed Treas. Reg. § 301.7701-1-11, 24 Fed. Reg. 10451-53 (1959).
30. Ray, note 5 *supra*, at 75-81.
31. Hewitt states that the Regulations provide that the standards are determined by the Internal Revenue Code, but the fact is that the standards are stated nowhere in the Code, only in the Regulations and in the cases. Hewitt, p. 215.

> among themselves and with the public at large, and the interests of the members of the organization in its assets.[32]

Thus the Service, indirectly, has made local law determinative of the classification of organizations. This statement is a reversal of the previous tax policy of the Service and many Supreme Court determinations, which have always maintained that local law is not controlling.[33]

### *Corporate Characteristics*

The new Regulations list six characteristics that are normally found in a corporation. These are (1) associates, (2) an objective to carry on business and divide the gains, (3) continuity of life, (4) centralization of management, (5) limited liability, and (6) free transferability of interests.[34] Since the first two characteristics are essentials of both corporations and partnerships, the Commissioner states that they should not be used in distinguishing a corporation from a partnership for tax purposes.[35] All of the remaining factors are not needed in order to qualify as an association; however, the Regulations provide that there must be a sufficient number present so that the organization more nearly resembles a corporation than a partnership or a trust.[36] This seems to be an embodiment of the principles of the *Morrissey* case. Yet in another paragraph of this same section the Regulations state that *more corporate characteristics* than non-corporate characteristics are needed to classify an entity as an association.[37] Logically, it would seem from this latter language that at least three of the last four characteristics (which the Commissioner has regarded as valid criteria) are needed to gain association status.[38] The Commissioner takes no position as to the relative importance of these distinguishing features. The scope of this controversy can be seen only by examining in detail each of the distinguishing characteristics.

#### *Continuity of Life*

According to the Regulations continuity of life exists if death, insanity, bankruptcy, retirement, resignation, or expulsion of any member

32. Treas. Reg. 301.7701-1(c) (1960).

33. Treas. Reg. 118, § 19.3797-1-9 (1940). United States v. Kintner, note 7 *supra;* Morrissey v. Commissioner, note 13 *supra;* Weiss v. Weiner, note 21 *supra.*

34. Treas. Reg. § 301.7701-2(a)(1) (1960).

35. Treas. Reg. § 301.7701-2(a)(2) (1960). The Regulations (Treas. Reg. § 301.7701-2 (a)(1) (1960)) also state in this paragraph that other corporate characteristics may be considered. Hewitt, at 216, suggests that these other characteristics might include a seal, certificates of interest, formal directors' meetings, and the holding of title to property.

36. Treas. Reg. § 301.7701(a)(1) (1960).

37. Treas. Reg. § 301.7701-1(a)(3) (1960).

38. For a discussion of this problem see Stutsman, *New Kintner Regs, Not Retroactive, Give Specific Criteria to Test Partnership,* 12 J. TAXATION 174, 177 (1960).

will not cause a dissolution of the organization.[39] A dissolution is defined by the Regulations to mean any alteration of the identity of an organization by reason of a change in the relationship between its members. Local law is made determinative as to whether a dissolution has been effected. In this regard the final Regulations have added to the proposed Regulations the restricting provision that a partnership subject to the Uniform Partnership Act (hereafter referred to as the UPA) or to some other similar local statute lacks continuity of life.[40] Under the UPA, which has been adopted in thirty-eight states, or the common law (which would apply in states without statutes) any change in the relation of the partners by any partner leaving the business constitutes a dissolution of the partnership.[41] As a practical matter, however, the business is usually *not* dissolved, or even interrupted, for the partners usually state in their agreement that on the death or withdrawal of a partner, the remaining partners will form a new partnership. Notwithstanding such agreements, however, it seems unlikely that any partnership could meet the technical requirement of "continuity of life" in the Regulations.[42]

*Centralization of Management*

Centralized management exists if the organization gives exclusive, continuing authority to one person or a group of persons, less than the whole, to make the decisions necessary to conduct the business.[43] The executive must perform more than purely ministerial acts and must be free to act without first receiving authorization from the entire membership. The executive need not be a member of the organization. With respect to management the Regulations state that any partnership subject to the UPA or a similar statute cannot achieve centralized management because the mutual agency relationship which exists in a general partnership gives each partner acting within the scope of the business the power to bind the partnership.[44] Although the partners can agree to vest the exclusive power to bind the partnership in a selected few, this agreement is ineffective as to outsiders without notice. The Regulations thus say in effect that a partnership can never have centralized management because in one instance a central committee could not exert absolute control

39. Treas. Reg. § 301.7701-2(b)(1) (1960).

40. Treas. Reg. § 301.7701-2(b)(3) (1960). Section 29 of the UNIFORM PARTNERSHIP ACT states that "[t]he dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business." OHIO REV. CODE § 1775.28. See also UNIFORM LIMITED PARTNERSHIP ACT §§ 20, 21; OHIO REV. CODE § 1781.20 (Supp. 1960).

41. CRANE, PARTNERSHIPS 390-91 (2d ed. 1952).

42. For a detailed analysis of this characteristic see Hewitt, 217.

43. Treas. Reg. § 301.7701-2(c) (1960).

44. Treas. Reg. § 301.7701-2(c) (1960); see CRANE, PARTNERSHIPS 348 (2d ed. 1952).

over the business affairs of the partnership. This appears to be a strange and narrow distinction when one considers an analogous situation in corporation law. Although the board of directors of a corporation, analogous to an executive committee in a partnership, has the power to define and limit the authority of a corporate officer, such officer acting within the scope of the business has the power to bind the corporation, even if in fact the board of directors has not given him the authority to do so.[45] The Regulations seem to state that a partnership must have a more centralized managment than a corporation in order to satisfy this characteristic and be classified as a corporation for tax purposes.[46]

*Limited Liability*

Limited liability exists if no single member of the organization is personally liable for the debts of or claims against the organization.[47] The Regulations specifically state that no partnership subject to the UPA possesses such limited liability, since under the UPA, notwithstanding any agreement between the partners, personal liability exists with respect to each partner.[48] While this dictinction is no doubt valid, it must be remembered that, practically speaking, most professional partnerships today have eliminated the drastic possibilities of personal liability through the use of insurance and agreements to the effect that no partner will be liable for the wrongful acts of fellow partners unless he is a direct party to such acts.

*Free Transferability of Interests*

An organization has free transferability of interests if each of its members has the power to transfer all the attributes of his interest[49] to others without the consent of other members.[50] This characteristic does not exist, however, if under local law a transfer of a member's interest

45. STEVENS, CORPORATIONS 771-73 (2d ed. 1949).

46. The Regulations state that a limited partnership can achieve centralized management if substantially all of the interests are owned by general partners. Treas. Reg. § 301.7701-2(c)(4) (1960). This statement seems to conflict with the *Morrissey* case which held that centralized management is essentially management by representation.

47. Treas. Reg. § 301.7701-2(d)(1) (1960).

48. Treas. Reg. § 301.7701-2(d)(1) (1960). UNIFORM PARTNERSHIP ACT § 16. This section states that there are specific instances in which personal liability does not exist, *viz.*, (1) when a general partner of a limited partnership has no substantial assets (however, in such a case the limited partners are personally liable); (2) when a corporation is a general partner and has no substantial assets outside of the partnership. Thus it seems that this characteristic would not be satisfied unless the general partners have no substantial assets outside of the partnership. What substantial assets are is not stated.

49. The assignment of the profits of an interest, which is allowed under the UNIFORM PARTNERSHIP ACT § 27 (1), is not a transfer of *all* the attributes of an interest, since this gives to the transferee no right to a voice in the management of the business.

50. Treas. Reg. § 301.7701-2(e) (1960).

results in a dissolution of the organization, even though the members by agreement allow the transfer of interest. Thus in a state that has passed the UPA, or a similar statute, or has adopted the common law rule which is similar to that under the UPA, no partnership could satisfy the characteristic since any transfer of an entire interest under the UPA results in a technical dissolution.[51]

The Regulations do allow for a modified form of free transferability.[52] This modified form exists when a member of an organization can transfer his interest to a non-member only after he has offered the interest to the remaining members at fair market value. The Regulations state, however, that this modified form of the characteristic will be given less significance in determining the classification of the organization than the true form.[53]

### *Examples in the Regulations*

The Regulations then present seven examples, two of which concern medical clinics.[54] The first example presents facts seemingly identical to those in the *Galt* case except that the management committee in the example is composed of four members while the committee in the *Galt* case had only two members. A further distinction lies in the fact that the members of the clinic in the *Galt* case by agreement were personally liable only when the assets of the clinic and the defaulting members had been used in full to reduce the debt, whereas in the example all members were personally liable for all debts of or claims against the clinic. In this example the Commissioner holds that, *under the "local applicable law,"* the clinic satisfies the corporate characteristics of centralized management, continuity of life, and the modified form of free transferability of interests. This apparently meets the test that an organization must have more corporate characteristics than non-corporate characteristics. Would the same result be reached if only the characteristics of continuity of life and centralized management were present? The Commissioner takes no position on this question, but the *Kintner* case and the 1939 Regulations under this section of the Code indicate that association status would be given to such an organization. This first example indicates that an entity similar to the one in the *Galt* case would be allowed to be taxed as a corporation. However, it is hard to imagine a state whose "local applicable law" would permit an organization to achieve the number of corporate characteristics required of an "association" under the Regulations. It is true that the characteristics might be met by a joint stock

51. UNIFORM PARTNERSHIP ACT § 29.
52. Treas. Reg. § 301.7701-2(e)(2) (1960).
53. *Ibid.*
54. Treas. Reg. § 301.7701-2(g)(1), (2) (1960).

company or a similar statutory entity, but presumably these latter forms differ from an association, according to the definition of a corporation in the Code as interpreted by the *Morrissey* case.[55]

In the other example concerning a medical clinic the articles of the entity provided for an organizational structure which would include all the corporate characteristics in the Regulations. However, when the local law was applied, the provisions of the agreement were rendered ineffective. The local law in effect negated the presence of any of the corporate characteristics. Thus the clinic was taxed as a partnership.

## VALIDITY OF THE REGULATIONS

The tone of the Kintner Regulations is contrary to previous authority. The new Regulations are different in two fundamental respects from the 1939 Regulations and court interpretations of the 1939 Regulations. First, the 1939 Regulations did not include the characteristics of limited liability and transferability of interest in the definition of an association.[56] Secondly, local law was stated to be of no importance in the 1939 Regulations. Thus the Service was allowed to look at the agreement, instead of local law, in order to decide whether the characteristics of an "association" existed.

The *Kintner* case was decided on similar reasoning. Had the *Kintner* case been decided under these new Regulations it undoubtedly would have gone the other way, for Montana has adopted the UPA. But the court in the *Kintner* case as well as the *Galt* case refused to look at mere form; instead, substance was examined to determine the actual characteristics of the clinic. Up to now the courts in the cases in this area have continually disregarded state law and looked to the articles or the agreement between the parties to determine whether or not the parties have in effect created an association with characteristics similar to those of a corporation. For instance, continuity of life existed if, according to the agreement between the parties, the business was not interrupted by the death or withdrawal of a partner. Centralized management existed if, according to the agreement, an executive committee smaller than the whole acted in its representative capacity to run the business.

There is no doubt that the new Regulations are contrary to previous authority such as the *Morrissey* and *Kintner* cases and the 1939 Regulations, which refused to make local law determinative and used the resemblance test rather than strict adherence to technical rules governing certain corporate characteristics. No doubt the new Regulations will be clarified and tested through litigation. Will the courts accept the Com-

55. See Morrissey v. Commissioner, note 13 *supra*. See also discussion at p. 778, *infra*.
56. Treas. Reg. 118, § 39.3797-2 (1940).

missioner's views or will the Regulations be declared inconsistent with the intent of Congress? That Congress intended the Commissioner to make regulations in this area is not in question.[57] What is in question is the meaning Congress intended in their use of the word "association." The Code indicates that the Commissioner has wide latitude in defining the term association and corporation since only the words, and no restriction or limitation, appear therein. However the decisions of the Supreme Court must be considered in determining the intent of Congress. The Supreme Court in the *Morrissey* case held that since the phrase joint stock companies is also used in the definition of the word corporation, association must mean something different from a bona fide corporation and a joint stock company. As discussed above, it would appear that the Kintner Regulations have limited the scope of the word association to such an extent that the only medical clinics that could qualify under the Kintner Regulations would be clinics organized as joint stock companies. Considering the above interpretation, it is at least questionable whether Congress intended to delegate such authority to the Commissioner.

One question remains. The court in the *Morrissey* case held that the definitions, while helpful, are not to be pressed so far as to make mere formal procedure a controlling test. The Kintner Regulations make formal procedure a controlling test by making local law determinative of the characteristics. For this reason, the new Regulations could cause grossly inequitable treatment of taxpayers. Taxpayers in similar organizations but in different states would be treated differently — some would be allowed to deduct pension plan payments, some would not. Such a determination would not provide the uniformity that is essential to a federal system of taxation. Therefore the formal and technical procedure for qualifying as an association under the Kintner Regulations could conceivably be declared invalid as being inconsistent with the intent of Congress.

Moreover the Commissioner seems to have discriminated against professional men while at the same time creating a loophole for such organizations as real estate syndicates and theatrical production companies that desire to act as corporations but who want to be taxed as partnerships in order to set off losses against personal income.[58]

It would seem entirely possible that the courts might disregard these regulations in favor of the "usual" tests of the *Morrissey* case, for there are reasonable grounds to hold that the *Kintner* Regulations are not only

57. Morrissey v. Commissioner, note 13 *supra*. The Supreme Court also stated in that case that the Commissioner could clarify and enlarge his Regulations once they were issued.
58. See Hewitt, 221.

impractical in application, but contrary to the intent of Congress as interpreted by the Supreme Court.

## PROPOSED ALTERNATIVES

If the Commissioner can make his Regulations stand, there remain several possible alternative courses of action, which, if successfully pursued, could permit professional men to attain the highly sought after tax-exempt pension and profit-sharing plans. One of these proposed alternatives is the Keogh-Simpson Bill (H.R. 10).[59] This bill was first introduced in 1951. In June of 1961 it passed the House in an amended form. The passage of this bill would alleviate the necessity of medical clinics and other professional groups qualifying as associations for federal tax purposes. The bill provides that a self-employed person who contributes to his own pension plan through a specially restricted form of life insurance or a trust will not be taxed on such contributions until the benefits from the plan are made available to him, usually after retirement. Under the bill, self-employed taxpayers who employ three or fewer employees must limit their annual contributions to $2500 or 10 per cent (whichever is smaller) of their annual income.[60] Self-employed employers with four or more full-time employees cannot participate in a tax deductible plan unless the plan covers all employees with at least three year's service. Also, contributions for employees must be vested. The current H.R. 10 is a compromise between earlier H.R. 10's and Treasury Department proposals, which have demanded that employers include vested contributions for employees in any tax-deductible pension plans.[61] The Treasury proposal provides that only those who actually perform personal services for the business involved can qualify. Further the deductible amounts cannot exceed ten per cent or $2500 of earned income unless vested contributions to employees' funds exceed that figure or the total contributions for the self-employed do not exceed one-half of the total contributions vested in employees or close relatives.

Last year the Senate Finance Committee amended H.R. 10 to such an extent that it is doubtful that the Senate will accept the House version.[62] The Senate bill contains restrictions on corporate plans covering stockholder-employees who own more than 10 per cent of the stock of the corporation; the House has refused to accept this provision.

59. Keogh-Simpson Bill, H.R. 10, 81st Cong., 1st Sess. (1951).

60. Senator Smathers has introduced a bill, S. 59, 87th Cong., 1st Sess. (1960), that calls for a $5000 or 20% of earned income limitation on annual deductions. See 39 TAXES 72 (1961).

61. For a more detailed discussion of the Treasury Department proposal, see Stutsman, *supra* note 38. See also, Hobbet, note 24 *supra*, at 42-44.

62. See 39 TAXES 72 (1961).

A second approach that would allow doctors and other professional groups to qualify for tax pension plans is the repeal of state laws prohibiting professionals from practicing as a corporation and the establishment of special state incorporation acts* for professional practitioners.[63] Two states, Connecticut and Oklahoma, already have special legislation which allows doctors to incorporate.[64] Similar legislation has been introduced in Indiana.[65] Under the Indiana proposal, the argument that incorporation of a profession will impair the traditional professional-client relationship is avoided by limiting the powers of the professional corporation so as to permit only one profession to be practiced in each corporation, to allow only professionals to hold stock in such corporations, and to preserve the personal liability of the practitioner for his wrongful acts while engaged in practice. The effect of this legislation would be that physicians could achieve tax status similar to "employees" under federal tax laws, and still be able to maintain the personal, confidential relationship with their patients that public policy demands.

*Ohio — Limited Partnership Associations*

Another possibility, more readily available, is the use of a common law joint stock company or its statutory counterpart — the limited partnership association. A joint stock company has the corporate characteristics of continuity of life, centralized management, and free transferability of interests. It does not have limited liability.[66] A medical clinic qualifying as a joint stock company would be taxed as a corporation, since section 7701(a)(3) of the Code expressly includes joint stock companies in the definition of a corporation. The member doctors could then be given tax-exempt pension plans. The use of the joint stock company would not be at all disadvantageous to doctors desiring to organize a medical clinic except for the unlimited liability aspect, which is also present in the partnership form. It is rarely used today, simply because most business groups find incorporation is easy and practical and also offers the protection of limited liability.

The limited partnership *association*, as distinguished from a limited partnership, is a business entity created by statute in three states (in-

* NOTE: While this issue of the Review was at press, the Ohio Professional Association Act (Senate Bill No. 550) was signed into law. The Act, which becomes effective October 17, 1961, permits doctors and other professionals to form "professional associations" for the purpose of obtaining retirement and profit-sharing benefits. Text of the act may presently be found at 7 CCH 1961 STAND. FED. TAX REP. § 6459.

63. See Lyon, note 5 *supra*.

64. CONN. GEN. STAT. ANN. tit. 33, §§ 180-82 (1951); OKLA. STAT. ANN. tit. 59, § 510 (1923).

65. See Lyon, note 5 *supra*.

66. ROWLEY, PARTNERSHIPS § 59.1 (2d ed. 1960). See also, Note, 11 WEST. RES. L. REV. 616, 629 (1960).

cluding Ohio) for the purpose of allowing the members to limit their individual liability.[67] The statute requires that the word "limited" appear in the name of the firm. It further states that not less than three nor more than twenty-five persons can form such an association and the association can last no longer than twenty years.[68] Of course there is nothing to stop the members from forming a new association when the old one has expired.

The limited partnership association has the corporate characteristics of limited liability, continuity of life,[69] centralized management,[70] and the modified form of transferability of interests.[71] The Commissioner in his 1939 Regulations expressly provided that statutory limited partnership associations would be taxed as corporations.[72] No mention is made of the limited partnership association in the new Kintner regulations, but it seems that this type of an association should qualify as a corporation under the new Regulations and section 7701(a)(3) of the 1954 Code.

The limited partnership association has rarely been used simply because there has been no need to use it. Those that have not found the partnership form adequate have found it relatively easy to incorporate. Although doctors will not use this type of association for its limited liability aspects alone, its use will serve doctors' needs adequately. The Attorney General of Ohio has recently issued an opinion which states that doctors may use the limited partnership association to form medical clinics.[73] Thus the path seems clear in Ohio, Michigan, and Pennsylvania for doctors to obtain their deductible pension plans.

## CONCLUSION

The final Kintner Regulations leave no room for doubt that the Commissioner will allow no unincorporated medical clinic short of a joint stock company to be classified as a corporation for federal tax purposes. Whether these Regulations will be allowed to stand in ensuing court tests is at least open to doubt in view of their adherence to local law and

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67. MICH. STAT. ANN. ch. 193, §§ 20.91-.107; PA. STAT. ANN. tit. 59, §§ 341-461; OHIO REV. CODE §§ 1783.01-.12.

68. OHIO REV. CODE § 1783.01.

69. OHIO REV. CODE § 1783.11.

70. OHIO REV. CODE § 1783.03 provides that ". . . [n]o debt shall be contracted, or liability incurred for the association, except by one or more of such managers [who are elected by the members] and no liability for an amount exceeding five hundred dollars, except against the person incurring it, shall bind the association unless reduced to writing and signed by at least two such managers."

71. OHIO REV. CODE § 1783.05. See also ROWLEY, PARTNERSHIPS § 54.4 (2d ed. 1960).

72. Treas. Reg. 118, § 39.3797-6 (1940).

73. Department Reports of the State of Ohio (March 27, 1961, at p. 278).

their consequent emphasis on form rather than substance. Even if they are upheld, doctors may be able to obtain their much desired tax-exempt pension and profit-sharing plans through the use of joint stock companies or similar statutory associations, such as the limited partnership association in Ohio. State professional incorporation acts and federal legislation patterned on the Keogh-Simpson Bill provide still other possible means for the obtaining of pension and profit-sharing plans.

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