



Case Western Reserve Law Review

Volume 13 | Issue 2

1962

The Ohio Professional Association Law

William J. Vesely

Follow this and additional works at: <https://scholarlycommons.law.case.edu/caselrev>

 Part of the [Law Commons](#)

Recommended Citation

William J. Vesely, *The Ohio Professional Association Law*, 13 W. Res. L. Rev. 195 (1962)

Available at: <https://scholarlycommons.law.case.edu/caselrev/vol13/iss2/5>

This Symposium is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Case Western Reserve Law Review by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.

Professional Associations

I

THE OHIO PROFESSIONAL ASSOCIATION LAW

William J. Vesely

INTRODUCTION

For perhaps a decade or more the Congress of the United States has had presented to it a series of bills, the purpose of which has been to extend to self-employed individuals, including professional men, tax benefits corresponding to the benefits enjoyed by employees under the qualified pension, profit sharing, and annuity plan provisions of the Internal Revenue Code.¹ These legislative proposals have been singularly unsuccessful. The most recent proposal² became so watered down with amendments designed to meet objections of the Treasury Department that there is serious doubt as to whether the restricted benefits it would provide justify the intensive legislative activity expended in its behalf. In these circumstances aggrieved taxpayers quite naturally looked for other means to meet the problem. The *Kintner* case,³ and similar cases,⁴ demonstrate the solution arrived at by some more audacious groups of taxpayers. At one time it was thought that these cases might provide the necessary authority for permitting associations of professionals to be taxed as corporations, and for professional men to qualify as employees of corporations for tax purposes. With the promulgation on November 15, 1960, of Treasury Decision 6503, the so-called Kintner Regulations,⁵ however, it was made clear that insofar as the Treasury Department is concerned, it is virtually impossible, at least in states which have adopted the Uniform Partnership Act and the Uniform Limited Partnership Act, to form a partnership or other unincorporated association which will qualify as an "association" for tax purposes. To overcome this new hurdle, or perhaps in order to avoid entirely the obstacles posed by the Regulations, the legislatures of many states have enacted professional association or professional corporation laws. The sole purpose of these laws is to permit professional men to organize and carry on their profes-

1. INT. REV. CODE OF 1954, §§ 401-04 [hereinafter cited as CODE §].

2. H.R. 10, 87th Cong., 1st Sess. (1961) (Jenkins-Keough Bill).

3. *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954).

4. *E.g., Galt v. United States*, 175 F. Supp. 360 (N.D. Tex. 1959).

5. 1960-2 CUM. BULL. 409; *Treas. Reg.* §§ 301.7701-1-11 (1960) [hereinafter cited as *Reg. §*].

sional practice as a corporation, or by means of a legal entity, whether or not called a corporation, which possesses the characteristics required for classification as an "association" under the Regulations, and thus is treated as a corporation for tax purposes. At the present time laws of this kind are in effect in fourteen states.⁶ A number of other states⁷ have considered legislation of this character but have not yet taken any action.

The laws which have been enacted to date can be grouped into two broad categories: (1) laws which are self-contained in the sense that they provide how the entity is to be organized, its shares issued, directors or managers selected and the like, without reference to the general corporation law,⁸ and (2) laws which are a part of, or incorporate by reference the provisions of, the general corporation law.⁹ The Ohio law is in the second group. There is a surprising variation in the provisions of the laws of the different states, although a basic pattern exists.¹⁰ As a general observation it might be said that the Ohio law represents the most succinct form of law, being in this respect like the laws of Illinois and Pennsylvania. It is understood that it is the form of bill which was considered but not acted upon by the legislature of the State of Indiana.¹¹

ESTABLISHING A PROFESSIONAL ASSOCIATION UNDER THE NEW ACT

The Ohio law¹² became effective on October 17, 1961. It consists of some eight separate sections which appear as sections 1785.01 through 1785.08 of the Revised Code. It provides for the creation of a new kind of corporate creature authorized to perform specifically designated pro-

6. Alabama, H. 138, Act No. 865, approved and effective Sept. 8, 1961, CCH 1961 STAND. FED. TAX REP. ¶ 6526; Arkansas, ARK. STAT. ANN. §§ 64-1701-1717 and 1801-1817 (Supp. 1961); Connecticut, CONN. GEN. STAT. ANN. [Public Act No. 158] (Supp. 1961); Florida, FLA. STAT. ANN. [ch. 61-64] (Supp. 1961); Georgia, GA. CODE ANN. §§ 84-4301-4318 (Supp. 1961); Illinois, ILL. ANN. STAT. ch. 106½, §§ 101-109 (Supp. 1961); Minnesota, MINN. STAT. ANN. §§ 319.01-23 (Supp. 1961); Ohio, OHIO REV. CODE §§ 1785.01-08 (Supp. 1961); Oklahoma, OKLA. STAT. ANN. tit. 18, §§ 801-819 (Supp. 1961); Pennsylvania, PA. STAT. ANN. tit. 14, §§ 197-1-19 (Supp. 1961); South Dakota, S.D. CODE ch. 163 (Supp. 1961); Tennessee, TENN. CODE ANN. § 61-05 (Supp. 1961); Texas, Tex. Laws 1961, ch. 158, § 6(3); Wisconsin, WIS. STAT. ANN. § 180-99 (Supp. 1961).

7. California, Indiana, Iowa, New York, North Carolina, Oregon, Rhode Island.

8. E.g., Illinois, ILL. ANN. STAT. ch. 106½, §§ 101-109 (Supp. 1961); Pennsylvania, PA. STAT. ANN. tit. 14, §§ 197-1-19 (Supp. 1961).

9. E.g., Oklahoma, OKLA. STAT. ANN. tit. 18, § 819 (Supp. 1961); Wisconsin, WIS. STAT. ANN. § 180.99(3) (Supp. 1961).

10. The Connecticut Law, CONN. GEN. STAT. ANN. [Public Act No. 158] (Supp. 1961), appears to be unique. It amended the Connecticut Uniform Partnership Law to authorize three or more persons to form an association having at least three of the four significant corporate characteristics required by the Regulations for classification as an association. The Texas law, Tex. Laws 1961 ch. 158, § 6(3), also makes special provision for professional associations in the Texas Uniform Partnership Act.

11. For a discussion of the Indiana bill see Lyon, *Action in Indiana on Kintner-Type Organizations*, 39 TAXES 266 (1961).

12. OHIO REV. CODE ch. 1785 (Supp. 1961).

fessional services. "Professional service" is a term of art, defined by reference to specific chapters of the Revised Code regulating the professions to which the act relates.¹³ It includes, in addition to the more generally recognized professions of law, medicine, dentistry, accounting, engineering, and architecture, a number of "limited branches of medicine or surgery."¹⁴ A professional association may perform only one professional service. For example, engineers and architects would not be permitted to organize a single professional association to practice both professions.

Classification

The Ohio law uses the identifying term "professional association."¹⁵ The provisions of the law refer to the entity variously as a corporation and as an association. The provisions of the general corporation law, to the extent they do not conflict with the provisions of the new law, are made applicable to professional associations.¹⁶ This is a strong indication that the new entity is, in fact, a corporation, despite the use of the identifying term "professional association."

Corporate Authority

Although a professional association may perform only the professional service for which it is organized, it has the authority to exercise the corporate powers and functions which every corporation may exercise in carrying out its proper corporate purpose. Thus the professional association may own the property it requires in order to perform professional services. This would include real property and both tangible and intangible personal property, provided such property is related to the carrying on of the corporation's professional purpose.¹⁷ For example,

13. See OHIO REV. CODE § 1785.01(A) (Supp. 1961).

14. For example, Suggestive Therapy, Magnetic Healing, Swedish Massage, and others as defined in section 4731.15 of the Revised Code are included.

15. The Ohio law, in this respect, is similar to the laws of Pennsylvania, (PA. STAT. ANN. tit. 14 §§ 197-1-19 (Supp. 1961), and of Illinois, ILL. ANN. STAT. ch. 106½, §§ 101-09 (Supp. 1961), and different from the laws of some other states which classify the organization as a "Professional Corporation," (OKLA. STAT. ANN. tit. 18, § 801 (Supp. 1961)), or "Service Corporation," (WIS. STAT. ANN. § 180.99(1) (Supp. 1961)).

16. OHIO REV. CODE § 1785.08 (Supp. 1961).

17. The laws of a number of states (Illinois, ILL. ANN. STAT. ch. 106½, § 104 (Supp. 1961); Oklahoma, OKLA. STAT. ANN. tit. 18, § 806 (Supp. 1961); Wisconsin, WIS. STAT. ANN. § 180.99(3) (Supp. 1961)) expressly authorize the professional association to invest its funds in real and both tangible and intangible personal property. A provision of this kind was dropped from the Ohio law during the legislative process. See Dunkel, *Professional Corporations*, 22 OHIO ST. L.J. 703, 709 (1961). The general corporation law, however, expressly authorizes corporations to purchase, invest in, and hold property of any description, and makes specific provision for investing funds in shares or other securities. See OHIO REV. CODE § 1701.13 (F) (6) (Supp. 1961). An Ohio professional association would have this authority, although limited to its professional purpose.

the corporation may wish to set aside funds for the purchase of new equipment, or for the remodeling or expansion of its space and facilities. Or it may wish to set aside funds as a reserve to fund an obligation to redeem outstanding shares upon the retirement or death of a shareholder. These purposes, and the investment of the funds set aside to accomplish them, would properly be within the scope of the association's permitted professional purpose.¹⁸

Organization

A professional association may be organized by¹⁹ and its shares issued only to²⁰ persons who are duly licensed or otherwise legally authorized to perform the same professional service as that for which the corporation is organized. Presumably the techniques of incorporation will be those used in organizing any business corporation.²¹ The Articles of Incorporation of the professional association are filed with the Secretary of State.²² An existing organization may amend its present agreement to the form necessary to constitute its articles of incorporation and then file this document.²³ The Secretary of State's office apparently will not, as a condition of filing the articles, require that the incorporators be professionally licensed persons.²⁴ But in view of the express language of section 1785.02 providing for organization by professionally licensed individuals, the better practice would be to use such professional persons as the incorporators. As with any corporation, a statutory agent will have to be designated and the shares of the professional association will have to be registered with the Division of Securities.²⁵

18. For a discussion of this problem in relation to the accumulated earnings tax, see Alexander, *Some Tax Problems of a Professional Association*, p. 219 *infra*.

19. OHIO REV. CODE § 1785.02 (Supp. 1961).

20. OHIO REV. CODE § 1785.05 (Supp. 1961).

21. The Secretary of State has issued a useful *Corporate Checklist*, in pamphlet form, setting forth the suggested procedures. If in view of the recent decision of the Ohio Supreme Court in State *ex rel.* Green v. Brown, 173 Ohio St. 114 (1962) (see note 59 *infra*), the Rules of Practice of the Supreme Court ultimately are amended to permit professional associations to practice law, additional requirements may be imposed in the case of such professional associations.

22. OHIO REV. CODE § 1785.06 (Supp. 1961).

23. See OHIO REV. CODE § 1785.02 (Supp. 1961): "Any such group of individuals who may be rendering a specific professional service as an organization created otherwise than pursuant to sections 1785.01 to 1785.08, inclusive, of the Revised Code may incorporate under and pursuant to the provisions of this act by amending the agreement establishing the organization in such manner that such agreement as amended shall constitute articles of incorporation prepared and filed in the manner prescribed in section 1785.08 of the Revised Code and by otherwise complying with the applicable requirements of sections 1785.01 to 1785.08, inclusive, of the Revised Code."

24. See OHIO REV. CODE §§ 1701.04(A), 1785.08 (Supp. 1961). Section 1701.04(A) requires only that incorporators be natural persons who are citizens of the United States. This section is made applicable to the incorporation of a professional association by section 1785.08.

25. OHIO REV. CODE § 1785.08 (Supp. 1961).

Corporate Name

There are no special statutory requirements concerning the corporate name. The provision of the general corporation law requiring that the name have a corporate ending²⁶ applies to professional associations.²⁷ The Secretary of State's office will require, as a condition to the filing of the articles, that the name include the name of one or more of the shareholders,²⁸ or that the name be one that has been in use by the organization prior to its incorporation, so as not to mislead.²⁹ The Attorney General has rendered an opinion³⁰ that the words "engineer" or "engineering" may not, in view of section 4733.16 of the Revised Code, be used in the name of a professional association. A dentist may practice dentistry through a professional association only if his name is included in the name of the professional association.³¹ Practice of the other professions is not subject to any such statutory requirement and, in the case of a professional association of attorneys, there is precedent permitting the use of a firm name which may include the names of only a few or none of the active attorneys.³²

ISSUANCE, TRANSFER, AND REDEMPTION OF SHARES IN A PROFESSIONAL ASSOCIATION

Shares may be issued only to persons licensed or otherwise legally authorized to perform the same professional service as the professional association and may be sold or transferred by a shareholder only to another professionally qualified individual.³³ Shareholders are not required to participate as directors, officers, or employees of the professional association in which they hold shares, nor is a professionally qualified person prohibited from holding shares in more than one professional association, provided he is professionally qualified to practice the same profession as each of the associations.³⁴

The Ohio law does not attempt to deal with a multiplicity of prob-

26. OHIO REV. CODE § 1701.04(A) (1) (Supp. 1961).

27. It is understood that this was not intended. The reference in section 1785.08 of the Revised Code to the requirements of section 1701.06(A) instead of section 1701.04(A) (1) apparently was inadvertent.

28. OHIO REV. CODE § 1785.06 (Supp. 1961). This practice is of doubtful validity. See Dunkel, *Professional Corporations*, 22 OHIO ST. L.J. 703, 710 (1961) referring to proposed section 1785.10, relative to the corporate name. It was not enacted into law.

29. See the *Corporate Checklist*, note 20 *supra*, issued by the Secretary of State.

30. No. 2531 OPS. ATT'Y. GEN. (Ohio 1961).

31. OHIO REV. CODE § 4715.18.

32. Canon 33 of the American Bar Association Canons of Professional Ethics.

33. OHIO REV. CODE §§ 1785.05-.07 (Supp. 1961).

34. However, dentists and dental surgeons are restricted by section 4715.18 of the Revised Code to membership in professional associations having offices in which they actually practice or in which they spend a majority of their time personally overseeing the work while the office is in operation. See also OHIO REV. CODE § 1785.01 (Supp. 1961).

lems incident to the ownership and transfer of shares. The obvious situations where problems can arise are the death of a shareholder, professional disqualification, and retirement from active participation in the association. Many of the problems can be resolved by an agreement among the shareholders, or by including in the articles of incorporation or the code of regulations provisions for the purchase and sale, or other transfer of the shares upon the occurrence of any of these events. The provisions could be made self-executing thereby avoiding the problem of the status, as well as the effect upon the professional association, of shares in the hands of non-professionally qualified persons.

A major concern in providing for the purchase, sale, and transfer of shares is the possible lack of authority of the professional association to repurchase its own shares in view of the statutory provision that shares may be "sold or transferred" only to professionally qualified individuals. The authority for a corporation to purchase its own shares is found in section 1701.35 of the Revised Code. A corporation also has authority under section 1701.23 of the Revised Code to redeem its own shares. Because of the express provision of the law restricting the sale or transfer of shares to professionally qualified individuals,³⁵ and notwithstanding the suggestion that a corporation's purchase of its own shares would not be a sale or transfer within the meaning of the law, there is serious doubt as to the authority of a professional association to purchase its shares pursuant to section 1701.35.³⁶

A redemption of its shares under section 1701.23, however, may be permissible. In order to redeem its shares, the necessary terms and conditions of the redemption must be set forth in the express terms of shares contained in the articles of incorporation.³⁷ The effect of such a redemption, unlike a purchase of shares under section 1701.35, would be to retire the shares, restoring them to the status of authorized and unissued shares. Of course, should the professional association proceed in accordance with section 1701.35, as a practical matter the question of corporate authority may never arise. The parties should recognize, however, that in the event of some disagreement among them the aggrieved party would be able to assert this defense.

Although no provision is made for the consequences of a purported sale or transfer of shares to, or their acquisition by, unauthorized persons, any attempt to make such a transfer would be ineffective in view of the

35. OHIO REV. CODE § 1785.05 (Supp. 1961).

36. The doubt is not resolved by resort to some inherent power of a corporation to purchase its own shares in the absence of statutory authority, the situation which existed in Ohio prior to the enactment in 1927 of section 8623-41 of the General Corporation Act. See 1 DAVIES, OHIO CORPORATION LAW 703-05 (1942). The issue rather is the effect to be given to the specific provision of the professional association law limiting sales and transfers to another licensed "individual."

37. OHIO REV. CODE §§ 1701.23 (B), 1701.04 (A) (4) (Supp. 1961).

provision limiting the transferees to professionally qualified persons.³⁸ The law also makes no provision for the consequences of the death or disqualification of a shareholder. In the absence of an agreement or restrictive provisions in the articles or regulations, presumably the shares of a deceased shareholder would continue as issued and outstanding shares in the hands of his executor or administrator. Does it follow that if such person is not professionally qualified, the professional association will be disqualified to perform professional services? Would this also be the case if the shareholder were disqualified? In the present state of the law there is no clear answer. It would seem that the lack of corporate authority to continue as a professional association could be asserted only in the manner, and by the persons designated in, section 1701.13(H) of the Revised Code.³⁹ This is a matter which will require corrective legislation,⁴⁰ although in at least one state, Florida, the Attorney General provided an interesting solution.⁴¹

PROFESSIONAL SERVICE AND MANAGEMENT OF THE PROFESSIONAL ASSOCIATION

The professional association may render professional services only through individuals licensed or otherwise legally authorized to perform such services.⁴² They need not be shareholders of the professional association. The law recognizes that the association may employ non-professional employees to perform services as clerks, bookkeepers, technicians, and other services of a non-professional character.⁴³ It also apparently recognizes that non-professionally qualified employees may perform, or assist in the performance of, professional services provided

38. OHIO REV. CODE § 1785.05 (Supp. 1961).

39. Section 1701.13(H) of the Revised Code provides: "No lack of or limitation upon, the authority of a corporation shall be asserted in any action except (1) by the state in an action by it against the corporation, (2) by or on behalf of the corporation against a director, an officer, or any shareholder as such, (3) by a shareholder as such or by or on behalf of the holders of shares of any class against the corporation, a director or an officer, or any shareholder as such, or (4) in an action involving an alleged overissue of shares."

40. The professional association laws of several states have detailed provisions for the transfer of shares in these circumstances. See OKLA. STAT. ANN. tit. 18, § 809 (Supp. 1961); WIS. STAT. ANN. § 180.99(10) (Supp. 1961).

41. An opinion of the Florida Attorney General (061-137, Sept. 12, 1961) states that where the owner dies the inheriting shareholders are permitted to amend the articles of the professional service corporation to continue as a general corporation to conduct other business.

42. Section 1785.03 of the Revised Code provides: "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 the state. The term 'employee' as used in this section does not include clerks, bookkeepers, technicians, 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, 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 corporation."

43. *Ibid.*

such services are performed under the direct supervision and control of a qualified professional officer, agent or employee of the professional association.⁴⁴ It is difficult to determine precisely the situation contemplated by this latter provision, because of the express requirement that professional services be performed only through duly licensed or legally authorized officers, agents, and employees. Possibly it has reference to medical and dental assistants, lab technicians, and other persons whose work might be viewed as being more directly a part of the professional services which the association performs, in contrast to the administrative work of secretaries, bookkeepers, and the like.

There is no statutory requirement, as there is in the laws of many states,⁴⁵ that the directors and officers be licensed professional persons. Notwithstanding the absence of a statutory prohibition, it would not be good practice to place non-professional men in responsible corporate positions.⁴⁶ The state licensing agencies supervising the practice of the professions would seem to have, through their control over the licensed individuals, the authority necessary to prohibit the practice of a profession by a professional association having non-professional directors or officers.

Preservation of Professional Relationship

The professional association laws uniformly provide some modification of the relationship that ordinarily exists between the officers and employees of a corporation and the persons dealing with the corporation, and of the legal consequences that attend such relationship. The Ohio law accomplishes this by providing that it does not modify any law affecting the legal relationship between the person who performs and the person who receives professional service, including liability arising out of such professional service.⁴⁷ In the absence of this provision, the person performing professional services, as would any employee, would be personally liable for his wrongful acts. But an employee acting in behalf of his employer ordinarily would have no contractual liability to third persons, whereas the professional employee, by reason of this provision, would have continuing personal liability for any obligations arising out of his performance of professional services, whether in contract or tort. Other important considerations undoubtedly are the preservation of the attorney-client and physician-patient relationship, notwithstanding that

44. *Ibid.*

45. *E.g.*, ILL. ANN. STAT. ch. 106½, § 101 (Supp. 1961); OKLA. STAT. ANN. tit. 18, § 810 (Supp. 1961); WIS. STAT. ANN. § 180.99(6) (Supp. 1961).

46. The rule of practice proposed by the Colorado Bar Association to the Supreme Court of Colorado deals with this problem by providing that lay directors and officers shall not exercise any authority over professional matters. Hodges & Moses, Report of Special Committee of the Colorado Bar Association to Consider the Desirability of Establishing Professional Service Corporations for the Practice of Law (October 11, 1961).

47. OHIO REV. CODE § 1785.04 (Supp. 1961).

in contemplation of law it is the professional association, and not its professional employee, which renders the professional service.

Since the statute refers to the person who performs and the person who receives professional service, apparently it does not affect the liability of the shareholders of a professional association in their capacity as shareholders. As a matter of corporate law, therefore, shareholders would have no liability as shareholders for corporate obligations. This is the significant relationship in determining whether the professional association satisfies the limited liability test of the Regulations.⁴⁸ Under the Ohio law, this test is met.⁴⁹

The professional association laws of a number of states⁵⁰ preserve the partnership rule of joint and several liability of all shareholders for claims arising out of the performance of professional services, or for the negligent or reckless conduct of any person, and limit the liability of shareholders only in the case of contractual and other claims arising in the ordinary course of business apart from the performance of professional services. The policy embodied in these laws represents a broad rule of professional responsibility, obligating each member of a group of professional associates to pledge his personal liability and resources to that organization, and to the acts performed by any person in its behalf. Presumably the relationship of trust and confidence involved is thought to require this broad professional responsibility. In view of the realities of modern professional practice, this is questionable.⁵¹ In any case it seems reasonably clear that the Ohio law follows the usual corporate rule of limited shareholder liability.⁵²

48. Reg. § 301.7701-2(d) (1960).

49. A recent article, Bittker, *Professional Associations and Federal Income Taxation: Some Comments and Questions*, 17 TAX L. REV. 1, 10-11 (1961), suggests that the equivalent provision of the Georgia Act (Section 7, GA. CODE ANN. §§ 84-4301-4318) may preserve among the members of the association the same mutual agency relationship which exists among partners under the Uniform Partnership Act, thus destroying the characteristic of limited liability. Since the Georgia Act, like the Ohio law, refers to the relationship between the person furnishing and the person receiving professional service and not to the relationship between the members or shareholders of the professional association and the person receiving professional service, there is doubt that it has the broad effect suggested by Professor Bittker. This interpretation seems even more doubtful under the provision of the Ohio law which does not, as does section 7 of the Georgia Act, make any reference to the liability of shareholders of the professional association in their capacity as shareholders.

50. CONN. GEN. STAT. ANN. [Public Act No. 158] (Supp. 1961); PA. STAT. ANN. tit. 14, § 197-17 (Supp. 1961); WIS. STAT. ANN. § 180.99(8) (Supp. 1961).

51. See Opinion 303 (1961), Committee on Professional Ethics and Grievances of the American Bar Association. This opinion holds that the restrictions on the personal liability of other lawyers in the professional association must be made apparent to the client. The rule proposed by the Colorado Bar Association (see note 46 *supra*) provides for professional liability insurance determined under a formula as a substitute for unlimited personal liability.

52. The argument that the Ohio law does not have this effect probably would be that since shareholders performing professional services for the association would not, because of the intervention of the corporate entity, be liable for acts of other shareholders also performing professional services for the association, the joint and several partnership liability rule which

Special Ethical Problems of Attorneys

The organization of a professional association of attorneys raises certain questions which are unique to the practice of law.⁵³ There are three principal areas of concern: (1) unconstitutional interference with the control of the judiciary over the practice of law, (2) unauthorized practice of law by a lay agency, and (3) violations of the Canons of Professional Ethics.

The Judicial Power and the Unauthorized Practice of Law

The Constitution of Ohio vests the judicial power in the judiciary⁵⁴ and prohibits the General Assembly from exercising any judicial power not expressly conferred upon it.⁵⁵ These constitutional provisions obviously do not prohibit the General Assembly from passing laws establishing courts, legal procedures, and other matters essential to the practice of law. The power of the General Assembly to pass laws specifically governing the practice of law by attorneys, fixing qualifications for admission to the bar, and establishing procedures for disbarment is well settled.⁵⁶ Law partnerships in the state of Ohio are organized under and governed by an act of the General Assembly, the Uniform Partnership Act. In fact, until the enactment of the Professional Association Law the constitutional power of the legislature to pass laws specifically governing the practice of law, as well as general laws having application to the legal profession as well as to other businesses, seemed to be unquestioned.

In a number of cases involving the unauthorized practice of law by lay agencies, however, the courts have used broad language to the effect that the legislature may not constitutionally authorize the practice of law by corporations, and that the conditions for admission to the bar and compliance with the rules of practice absolutely preclude a corporation from practicing law.⁵⁷ These statements were made in the context of a lay agency engaging in the practice of law at a time when the statutes ex-

previously applied to the relationship between such individuals and their clients would be modified. Therefore, section 1785.04 of the Revised Code which precludes modification of an existing professional relationship would apply to preserve that relationship. The argument requires a tortured construction of the statute and, in view of the direct way in which the personal liability of the associates, members, or shareholders has been preserved where that was intended (e.g., Connecticut, CONN. GEN. STAT. ANN. [ch. 61-64] (Supp. 1961); Pennsylvania, PA. STAT. ANN. tit. 14, §§ 197-1-19 (Supp. 1961)) it is not persuasive.

53. The accountants have had a long standing rule barring corporate practice. Rule 11, Rules of Professional Conduct, American Institute of Accountants, as revised December 19, 1950, C.P.A. HANDBOOK ch. 5, p. 6.

54. OHIO CONST. art. IV, § 1.

55. OHIO CONST. art. II, § 32.

56. OHIO REV. CODE ch. 4705; *In re McBride*, 164 Ohio St. 419 (1956).

57. *Judd v. City Trust & Sav. Bank*, 133 Ohio St. 81 (1937). See also *Steer v. Land Title Guarantee & Trust Co.*, 113 N.E.2d 763, 767 (Ohio C.P. 1953): "Any statute which would attempt to sanction, or even hint at the propriety of, a corporation's practicing law would be obviously invalid."

pressly prohibited the practice of law by any corporation.⁵⁸ It is doubtful that they are properly applicable to a special form of organization, subject to rigid professional requirements and authorized to perform legal services only through professionally qualified persons.⁵⁹ Except for the "intermediary" issue, hereinafter discussed, which is not a constitutional issue, it is difficult to see any significant difference between the practice of law by a professional association and by a law partnership.⁶⁰ The important factor, common to both, is that the organization performing legal services would be comprised of, and its services would be rendered by, professionally qualified individuals. Such individuals, and through them the professional association, necessarily would be subject to judicial supervision and control.

The unauthorized practice issue is essentially a question of the practice of law by a lay agency lacking the authority to do so. The professional association, provided it complies with the rules of practice established by the judiciary, will not be such an unauthorized lay agency.

The real concern in this area may be that the giving of legislative and judicial sanction to the practice of law by a corporation, even a special kind of corporation subject to quite restrictive rules, involves the serious risk of opening the floodgates to the practice of law by unauthorized persons. This could be an important practical consideration and one that merits the serious concern of the legal profession.

Considerations Regarding the Canons of Professional Ethics

The ethical questions center chiefly around three issues, reflected in Canons 31, 35, and 47 of the Canons of Professional Ethics of the Ameri-

58. See *Land Title Abstract Trust Co. v. Dworken*, 129 Ohio St. 23, 30-32, 193 N.E. 650, 653 (1934), citing with approval *In re Cooperative Law Co.*, 198 N.Y. 479, 92 N.E. 15 (1910).

59. See *In the Matter of the Florida Bar, Petitioner*, No. 31073 (Sup. Ct., Oct. 11, 1961) cited in 35 FLA. B.J. 1067 (1961). See Jones, *The Professional Corporation*, 27 FORDHAM L. REV. 353, 362 (1958). But see *In re Opinion of the Justices*, 279 Mass. 607, 180 N.E. 725 (1935), indicating that under no circumstances may a corporation practice law.

In its recent decision in *State ex. rel. Green v. Brown*, 173 Ohio St. 114 (1962), the supreme court denied the petitions in mandamus to require the Secretary of State to accept for filing articles of incorporation of professional associations formed to engage in the practice of law on the ground that Rule XIV of its Rules of Practice, adopted by the court under its inherent power to prescribe standards for the admission to the practice of law, did not permit practice by "any other than natural persons." The court did not, however, hold that a professional association, by its very nature, is precluded from carrying on the practice of law. It based its decision instead on the requirements of its existing rules of practice.

Several local bar associations in the State of Ohio filed briefs in the case. The general argument of these briefs was that the petitions for mandamus should be denied because of defects in the proposed articles of incorporation, but that no final decision should be made as to the inherent right of professional associations of lawyers to practice law until the organized bar of Ohio has had an opportunity to be heard by the Supreme Court. Presumably, the Supreme Court will now take under advisement the question of whether its Rules of Practice should be amended to permit professional associations to practice law.

60. Lewis, *Corporate Capacity to Practice Law — A Study in Legal Hocus Pocus*, 2 MD. L. REV. 342, 345 (1938).

can Bar Association. Briefly stated, these are: (1) the professional association would be an intermediary between the attorney and his client, and his primary responsibility would be to the association, in violation of Canon 35, (2) the professional association would be an unauthorized lay agency using the attorney's services in violation of Canon 47, and (3) the direct responsibility of the attorney for litigation and for selection of clients would be eliminated, in violation of Canon 31. Doubtlessly other ethical considerations could be raised, or the above three stated differently, but they are the ones of prime importance. Any professional association could practice in such a way as to violate all of them, but the corporate form of organization does not inherently violate any of them.⁶¹

It seems reasonably clear that a professional association of attorneys under the Ohio law would not be a "lay agency" within the meaning of Canon 35. It seems equally clear that the individual attorney will perform services for, and as an agent of, the professional association. In this sense the association will be an intermediary between the individual attorney and his client. In fact it is essential that this relationship exist, else the tax benefits realizable by reason of the attorney's status as an employee will be unavailable.⁶² The professional association and its attorneys could, by subordinating the interest of their clients to the interests of the association, carry on the practice of law in violation of Canon 35.⁶³ Nothing in the form of the organization requires that it do so.

One aspect of the professional association that is of legitimate concern is that as a matter of corporate law all of the authority of the cor-

61. The Committee on Professional Ethics and Grievances of the American Bar Association recently has issued Opinion 303, holding that the carrying on of the practice of law in the form of a professional association or professional corporation does not of itself constitute a violation of professional ethics, the substance of the arrangement, not the form, being the controlling consideration. The Opinion indicates that some members of the Committee entertain grave doubts as to the wisdom of practicing law through such a corporate vehicle, but find nothing inherently unethical in the use of this legal form. The Supreme Court of the State of Florida (See *In the Matter of the Florida Bar*, Petitioner, No. 3173 (Sup. Ct., Oct. 11, 1961) note 59 *supra*) has amended its Integration Rule and its Code of Ethics to permit the practice of law by corporations organized under the Florida law. The Board of Governors of the Colorado Bar Association on October 11, 1961 adopted a resolution recommending the adoption by the Supreme Court of Colorado of a rule permitting lawyers to incorporate.

62. Rev. Proc. 61-11, 1961-1 CUM. BULL. 897.

63. See the oft quoted language from *In re Cooperative Law Co.*, 198 N.Y. 479, 483-84, 92 N.E. 15, 16 (1910), which refers to a corporation conducted wholly by laymen, with no lawyer among its stockholders, directors, or officers: "The relation of attorney and client is that of master and servant in a limited and dignified sense, and it involves the highest trust and confidence. It cannot be delegated without consent and it cannot exist between an attorney employed by a corporation to practice law for it, and a client of the corporation, for he would be subject to the directions of the corporation and not to the directions of the client. There would be neither contract nor privity between him and the client, and he would not owe even the duty of counsel to the actual litigant. The corporation would control the litigation, the money earned would belong to the corporation and the attorney would be responsible to the corporation only. His master would not be the client but the corporation, conducted it may be wholly by laymen, organized simply to make money and not to aid in the administration of justice which is the highest function of an attorney and counselor at law."

poration is exercisable by the directors. They have specific authority to select officers, to determine their authority and duties,⁶⁴ and to fix their compensation.⁶⁵ This centralization of management is, of course, one of the corporate attributes which the professional association law is intended to provide. In a broad sense, then, the attorney's work is subject to the direction of another. If the directors are lawyers active in the practice of the professional association, however, there should be no violation of professional ethics.⁶⁶ But if this kind of control over a lawyer's work raises ethical problems, then, as has been well pointed out,⁶⁷ these same ethical concerns may exist today for law partnerships which employ non-partner lawyers.

QUALIFICATION AS A CORPORATION FOR TAX PURPOSES

The professional association will be useful only if it will qualify as a corporation for tax purposes by satisfying the conditions required by the Treasury Regulations for classification as an "association." There is also an argument made that the professional association could qualify for tax purposes by reason of being classified as a "corporation" under state law and, therefore, not subject to the tests imposed by the Regulations.⁶⁸ This position apparently assumes that the incorporation by reference of the provisions of the general corporation laws of the various states in their professional association or professional corporation laws removes the professional organization from the scope of the Regulations. Presumably this argument would not be available to professional associations organized under laws of the kind passed by Pennsylvania and Illinois, which identify the organization as a professional association and do not make any reference to the corporation law.

The position is doubtful in view of the statutory provisions applicable to professional corporations, the express purpose of which is to modify to some extent the usual attributes of the ordinary business corporation in order to meet professional standards. In the event of any conflict, the provisions of the professional corporation law control.⁶⁹ Obviously there are sound reasons, in such circumstances, for applying a uniform standard in determining whether the professional corporation has sufficient significant corporate attributes to warrant classification as a corporation for

64. OHIO REV. CODE § 1701.64 (Supp. 1961).

65. OHIO REV. CODE § 1701.60 (Supp. 1961).

66. Opinion 303, Committee on Professional Ethics and Grievances of the American Bar Association.

67. Porter, *et al.*, Report of the Special Committee of the Section of Taxation of the American Bar Association to Cooperate with the Committee on Professional Ethics re Association of Attorneys Taxable as Corporations (July 17, 1961).

68. See Alexander, *Some Tax Problems of a Professional Association*, pp. 232-33 *infra*.

69. OHIO REV. CODE § 1785.08 (Supp. 1961).

tax purposes.⁷⁰ Applicability of the appropriate standard should not be governed by the name which the state law chooses to give to the professional organization.⁷¹ Apparently the Internal Revenue Service will not consider the terminology of the particular professional corporation law to be controlling,⁷² or even significant, and will apply to corporations formed under these laws the same tests which it applies to associations and other unincorporated organizations.

The two basic characteristics provided in the Regulations⁷³ as being common to all corporations are (1) the presence of associates and (2) an objective to carry on business and divide the gains therefrom. Under the Ohio Professional Association Law the shareholders would be the "associates." Except for a professional association organized by one individual and having only one shareholder, the professional association should satisfy these two basic requirements.⁷⁴ The one-man professional association would lack "associates" because there would be no one, other than the sole shareholder, who would participate in the business in order to divide the gains therefrom.⁷⁵

The remaining four significant corporate characteristics under the Regulations are (1) continuity of life, (2) centralization of management, (3) limited liability, and (4) free transferability of interests. The first condition is met under the Ohio law. The organization will not be dissolved by reason of the death, insanity, bankruptcy, retirement, resignation, or expulsion of any shareholder.⁷⁶ Dissolution can be effected

70. It does not follow that the requirements of the Regulations represent the proper standard. See Note, *Qualified Pension Plans for Unincorporated Professional Associations*, 12 STAN. L. REV. 746, 758 (1960), suggesting that continuity of existence and centralized management are the most vital elements and pointing out that restrictions upon the transfer of corporate stock are both lawful and common in closely held corporations and that limitation of personal liability, while a typical corporate attribute, has been held not an essential corporate characteristic.

71. See Bittker, *Professional Associations and Federal Income Taxation: Some Comments and Questions*, 17 TAX L. REV. 1, 25-26 (1961).

72. Reg. § 301.7701-1(b), (c) (1960).

73. Reg. § 301.7701-2(a) (1960).

74. It is possible that if the income were allocated among the shareholders under a method which, in substance, would treat each shareholder as an independent contractor earning his own fees, the business would not be conducted for "joint profit" within the meaning of Regulation section 301.7701-2(a)(2) (1960).

75. Note, *Qualified Pension Plans for Unincorporated Professional Associations*, 12 STAN. L. REV. 746, 756 (1960). Should a one-man professional corporation somehow qualify, notwithstanding the absence of associates, the Treasury may nevertheless assert that for tax purposes the corporate entity is to be disregarded. See Jones, *The Professional Corporation*, 27 FORDHAM L. REV. 353, 371 (1958).

76. The Ohio law does not provide what the consequences are, if any, if the enumerated events occur and if the shares of the person in question are not transferred to a professionally qualified person or redeemed by the professional association. The view has been expressed that under a similar professional association law the consequences could be the termination of the life of the professional organization. See Bittker, *Professional Associations and Federal Income Taxation: Some Comments and Questions*, 17 TAX L. REV. 1, 15-17 (1961), discussing section 11 of the Georgia Act (GA. CODE ANN. §§ 84-4301-4318) which specifically

only by following the established dissolution procedures under the corporation law.

Satisfaction of the third condition also seems reasonably certain. The shareholders will not, by reason of their status as shareholders, have any personal liability for debts of or claims against the association.⁷⁷

The other two significant corporate characteristics, (2) centralization of management and (4) free transferability of interests, can be satisfied by a professional association formed under the Ohio law.⁷⁸ There are, however, practical considerations affecting all professions which will permit the fourth characteristic to exist, if at all, only in a modified form.

The centralization of management requirement relates to the authority to make the management decisions of the professional association. The Regulations do not specify what is encompassed by the term "management decisions." The statement in the Regulations that the persons having this authority "resemble in power and functions the directors of a statutory corporation"⁷⁹ would indicate that this test does not require direct, day to day supervision of the work of the professional corporation.⁸⁰ Satisfaction of this condition, therefore, would not seem to require control of a kind which would conflict with the professional responsibility of the employees performing professional services in behalf of the professional corporation.

Under the Ohio law the professional association, as does any corporation, has centralization of management in form through its board of directors.⁸¹ One ordinarily would consider this sufficient to satisfy this test. The Regulations, however, expressly provide that the group which has continuing exclusive authority to make the management decisions must not include all the members,⁸² thus making this a substantive test of sorts. As applied to an Ohio professional association this would mean

provides for dissolution of the professional association in the event a disqualified associate fails to sever all interest in the professional association. Although there are gaps in the Ohio law in treating the problem of disqualified and deceased shareholders, it can not be assumed that the consequence is dissolution of the professional association.

77. See p. 203 *supra*. See also note 49 *supra* and accompanying text.

78. The statutory provision restricting transferees of shares to professionally qualified individuals (OHIO REV. CODE § 1785.07) does not violate the free transferability of interest test. See Reg. § 301.7701-2(g), Example (1) (1960).

79. Reg. § 301.7701-2(c) (1) (1960).

80. Note, *Qualified Pension Plans for Unincorporated Professional Associations*, 12 STAN. L. REV. 746, 760 (1960): "It is clear that the people responsible for the everyday work of the corporation make many management decisions potentially binding the corporation. In fact, the function of the board of directors of a corporation is essentially to guide the direction of the corporation. . . ."

81. The Internal Revenue Service may assert that the provisions of law preserving the professional relationship between the person performing and the person receiving professional service overrides the provision of the Ohio general corporation law vesting management of the corporation in its directors. See Bittker, *Professional Associations and Federal Income Taxation: Some Comments and Questions*, 17 TAX L. REV. 1, 10-13 (1961).

82. Reg. § 301.7701-2(c) (1) (1960).

that all of the shareholders may not be directors of the corporation. Literal compliance with this provision would require that a professional association having three or less shareholders have at least one non-shareholder as a director. A director who is not professionally licensed clearly would be unacceptable in some professions, such as law, medicine, accounting, and perhaps in all professions. The use of professionally qualified non-shareholder directors may offer a possible solution in the case of some professions.

It also is possible that the Internal Revenue Service will do more than merely count the number of shareholders and the number of shareholders serving as directors in determining whether centralization of management exists. If the non-director shareholders have only a small interest in the organization, there is some reason to believe that the Service would not consider this as meeting the centralization of management test.⁸³

The free transferability of interests test of the Regulations, as a practical matter, will be difficult to meet. Any restriction on the free transferability of shares modifies this characteristic to some extent. The Regulations recognize that a provision requiring that the shares be offered to the other shareholders at their fair market value does not destroy this characteristic, describing such an arrangement as "a modified form" of free transferability of interests.⁸⁴ But the customary form of restrictive stock provisions usually involves a formula price, or some other price, not stated in terms of market value, although it presumably represents the parties' best estimate of a means for determining what the stock will be worth in the future. Thus in view of the very restrictive and technical view of the Internal Revenue Service reflected in the Regulations, it may be expected that the Service will not look favorably on restrictive stock provisions.⁸⁵

To summarize, except for the special situation of the one-man corporation, or a two or three-man corporation in which all shareholders also are directors, a professional association formed under the Ohio law should be able to satisfy all the requirements of the Regulations, with the possible exception of the free transferability of interests test. In many cases it should be able to satisfy that requirement in a modified form. Accordingly, it should qualify for treatment as a corporation for tax purposes under the Treasury's Regulations.

83. Reg. § 301.7701-2(c) (4) (1960).

84. Reg. § 301.7701-2(e) (2) (1960).

85. Porter, *et al.*, Report of the Special Committee of the Section of Taxation of the American Bar Association to Cooperate with the Committee on Professional Ethics re Association of Attorneys Taxable as Corporations (July 17, 1961).

Other Tax Requirements

Classification of the professional association as an association or corporation for tax purposes will not provide the complete answer to the tax problems of professional men in the area of retirement benefits. It is only the first step. A further condition is that the professional employees qualify as "employees" of the professional association for tax purposes.⁸⁶ This will be determined by the overall relationship between the professional employee and the professional association and will not depend upon any narrow "control" test. It appears to be well settled, and the Internal Revenue Service apparently recognizes, that the specialized and technical nature of professional work means that the control of an employer over the manner in which the professional employee conducts the duties of his position necessarily must be more tenuous and general than the control over non-professional employees.⁸⁷ A number of factors⁸⁸ will be considered in determining whether the necessary relationship exists.

Finally, the association's pension or profit-sharing plan must meet the requirements for qualification under the Internal Revenue Code and Treasury Regulations. These will be the same requirements applicable to qualified plans generally.⁸⁹ The factors of principal concern will be the requirements that the plan benefit employees in general and that it does not discriminate respecting contributions or benefits in favor of officers, shareholders, or highly compensated employees. Profit-sharing plans probably will be found to be best adapted to most professional associations⁹⁰ by permitting greater flexibility in determining annual contributions and in avoiding a fixed annual obligation, factors of particular importance to the smaller enterprise.

86. See Rev. Proc. 61-11, 1961-1 CUM. BULL. 897, discussed in Alexander, *Some Tax Problems of a Professional Association*, pp. 225-27 *infra*. One might properly ask why this requirement apparently is stressed by the Service in the case of professional associations since it rarely, if ever, has been a factor in qualifying plans for smaller, closely held corporations.

87. Wendell E. James, 25 T.C. 1296 (1956); Rev. Rul. 61-178, 1961 INT. REV. BULL. NO. 41, at 8; Special Ruling dated March 2, 1961, relative to a medical corporation organized under the laws of the State of Connecticut, reported in 7 CCH 1961 STAND. FED. TAX. REP. ¶ 6375.

88. The factors enumerated in the Special Ruling (See note 87 *supra*.) are (1) the degree to which such individual has become integrated into the operating organization of the employer; (2) the substantial nature, regularity, and continuity of his work for the employer; (3) the authority vested in or reserved by the employer to require compliance with his general standards and policies; and (4) the degree to which the individual under consideration has been accorded the rights and privileges of other clearly recognized employees.

89. See Rev. Rul. 61-157, 1961 INT. REV. BULL. NO. 35, at 8. The Internal Revenue Service will not permit the past services of partners to be taken into account in satisfying eligibility requirements and qualifying for prior service benefits. Rev. Proc. 61-11, 1961-1 CUM. BULL. 897. This could create a serious inequality between partners having a long period of service and professional employees with relatively few years of service.

90. Opinion 303 of the Committee on Professional Ethics and Grievances of the American Bar Association concludes that a profit sharing plan which includes lawyers and non-lawyers would effect an unethical division of fees in violation of Canon 34.