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THE BUSINESS TRUST AS AN ORGANIZATION FOR PRACTICING LAW

On numerous occasions Congress has recognized the substantial inequities in the tax structure for professional men who must conduct their business in partnership form, and the Internal Revenue Service has recently reaffirmed a desire to perpetuate those inequities.¹ Organizations that can meet the requisites for taxation as a "corporation" or "association" under the Internal Revenue Code receive manifold tax benefits a partnership cannot which are too familiar to require enumeration.² The

150. While the same criticism might be made of application of the substantial evidence rule to jury and agency, it can be argued that whatever differences in application exist have been settled by several decades of practice under the rule.

1. See, *e.g.*, H.R. Rep. No. 64, 86th Cong., 1st Sess. 4 (1959); S. Rep. No. 1615, 86th Cong., 2d Sess. 2 (1960).

On December 17, 1963, The IRS published its long awaited proposed regulations to Treas. Reg. § 301.7701-1-2. Proposed Treas. Reg. §§ 301.7701-1-2, 28 Fed. Reg. 243 (1963). If adopted, these regulations would exclude any possibility of professional persons gaining corporate tax advantages. These proposed regulations, it is hardly necessary to say, will be vigorously opposed, and face a slim chance of being adopted in their present form.

2. Briefly summarized these benefits are: contributions to qualified pension and profit sharing plans for lawyer-employees are deductible from income, INT. REV. CODE OF 1954, § 401(a); when profit sharing and pension plans are utilized, amounts up to 25 per cent of employees' yearly compensation is deductible, INT. REV. CODE OF 1954, § 404(a)(7); the income from such plans is tax exempt, and may be reinvested tax free, *ibid*; contributions made on behalf of an employee are not included in his income until the money is actually received by him, INT. REV. CODE OF 1954, § 402; if an employee elects to receive the entire amount from these plans within one year of termination of his employment, the amount received may be declared a long term capital gain, INT. REV. CODE OF 1954, §§ 402(a)(2), 1201(b); premiums on group life, health

1962 Self-Employed Individuals Tax Retirement Act was originally conceived to equalize in large measure the tax benefits available to the various business forms, but as a consequence of its long and arduous battle in Congress over a period of twelve years, the Keough Bill established little more than a limited pension plan.³

A result of the Keough Bill's practical failure has been that states continue to enact professional association and corporation statutes in an attempt to invest business forms with those characteristics which, under the Kintner Regulations, would entitle them to taxation as an association.⁴ At present, the Treasury Regulations prescribe that organizations qualify

and accident insurance policies are not included in an employee's income, INT. REV. CODE OF 1954, § 106; such payments are deductible from the organization's income, INT. REV. CODE OF 1954, § 106; payments by the corporation for sick or injured employees up to one hundred dollars a week are excluded from their income, INT. REV. CODE OF 1954, § 105(d); payments to an employee and his family as reimbursement for medical expenses are receivable tax free, INT. REV. CODE OF 1954, § 105(b); and finally, payments up to five thousand dollars to the beneficiary or estate of a deceased employee are tax free, INT. REV. CODE OF 1954, § 101(b).

3. INT. REV. CODE OF 1954, as amended, 76 Stat. 809 (1962). Not only is the pension plan allowed under the act much less comprehensive, but it does not provide for the five thousand dollar tax free death benefit, one hundred dollar a week sick pay exclusion or the estate and gift tax exclusions available to corporate employees. See Grayck, *Tax Qualified Retirement Plans for Professional Practitioners: A Comparison of the Self-Employed Individuals Tax Retirement Act of 1962 and the Professional Association*, 63 COLUM. L. REV. 415, 432 (1963).

For a general history of the efforts to secure for self-employed persons the same advantages which are available to corporation employees, see Rapp, *The Quest for Tax Equality for Private Pension Plans: A Short History of the Jenkins-Keogh Bill*, 14 TAX L. REV. 55 (1958), and Rapp, *Pensions for the Self-Employed: The Treasury Department—Finance Committee Plan*, 16 TAX L. REV. 227 (1961).

4. At least 30 states have authorized the use of a corporate form of organization by professional practitioners. The professional association statutes are: ALA. CODE tit. 46, §§ 330 to 345 (Supp. 1961); CONN. GEN. STAT. ANN. §§ 34-82 (Supp. 1962); GA. CODE ANN. §§ 84-4301 to -4318 (Supp. 1963); ILL. ANN. STAT. ch. 106½ §§ 101 to 111 (Smith-Hurd Supp. 1963); OHIO REV. CODE ANN. §§ 1785.01 to .08 (Page Supp. 1963); PA. STAT. ANN. tit. 14 §§ 197-1 to -9 (Purdor Supp. 1962); S.C. CODE ANN. §§ 56-1601 to -1617 (Supp. 1963); TENN. CODE ANN. § 61-105(3) (Supp. 1963); TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon Supp. 1962); VA. CODE ANN. §§ 54-873 to -898 (Supp. 1962).

The professional corporation statutes are: ARIZ. REV. STAT. ANN. §§ 10-901 to -909 (Supp. 1963); ARK. STAT. ANN. §§ 64-2001 to -2018 (Supp. 1963); FLA. STAT. ANN. §§ 621.01 to .14 (Supp. 1962); IDAHO CODE ANN. §§ 30-1401 to -1414 (Supp. 1963); KY. REV. STAT. §§ 274.005 to .990 (1962); MASS. LAWS 1963, S.B. 931 (1963); MICH. STAT. ANN. §§ 21.315(1) to .315(15) (Supp. 1963); MINN. STAT. ANN. §§ 319.01 to .23 (Supp. 1963); MO. ANN. STAT. §§ 356.010 to .200 (Vernon Supp. 1963); MONT. REV. CODES ANN. §§ 15-2101 to -2116 (Supp. 1963); NEV. LAWS 1963, ch. 385; N.J. STAT. ANN. §§ 14: 19-1 to 19-17 (Supp. 1963); N.M. STAT. ANN. §§ 51-22-1 to -22-13 (Supp. 1963); N.D. CENT. CODE §§ 10-31-01 to -31-14 (Supp. 1963); OKLA. STAT. tit. 18 §§ 801 to 819 (1961); S.D. Sess. Laws 1961, ch. 29, §§ 1-19 as amended by S.D. Sess. Laws 1963, ch. 34; UTAH CODE ANN. §§ 16-11-1 to -11-15 (Supp. 1963); VT. STAT. ANN. tit. 11, §§ 901 to 913 (Supp. 1963); WIS. STAT. ANN. §§ 180.99(1) to (11) (Supp. 1963).

Colo. Sup. Ct. (Civ.) R. ch. 19, § 231 authorizes lawyers to form professional corporations in accordance with the Colorado Corporation Code.

as associations within the Internal Revenue Code if they possess the "primary" corporate characteristics of associates and an object to carry on a business and divide profits, as well as a majority of the "secondary" corporate characteristics of limited liability, centralization of management, free transferability of interests and continuity of life.⁵ Additionally, while the code and regulations establish and define the characteristics or standards of an association, they also provide that local law is determinative as to the existence of these characteristics in a particular organizational form.⁶ It is the latter provision which has given impetus to the enactment of the above-mentioned state statutes.

Indiana's legislators have not been unmindful of the tax benefits that have been denied that state's recognized professions. In the 1961 General Assembly a "Professional Corporation Act" was introduced to provide corporate tax benefits for the state's traditional professions which failed to win final approval, and the 1963 Assembly enacted a "Professional Medical Corporation Act" allowing doctors to seek corporate tax advantages.⁷ The 93rd Assembly also passed the "Indiana Business Trust Act of 1963," presumably enacted merely to resolve the uncertain legal status of the business or "Massachusetts" trust as a permissible

5. Treas. Reg. §§ 301.7701-2(a)(2), (3) (1960).

The Income Tax Law of 1913 (32 Stat. 172 § 2(g)) provided for taxing the net income of "every corporation, joint-stock company or association, and every insurance company organized in the United States, no matter how created or organized, not including partnerships." Interpretation of the word "association" was filled with a great deal of uncertainty until the landmark case of *Morrisey v. Commissioner*, 296 U.S. 344 (1935), was decided. Chief Justice Hughes, delivering the opinion of the Court, enumerated the textually stated primary and secondary characteristics which are used to determine whether organizations are to be classified as associations for purposes of the Internal Revenue Code. *Id.* at 357.

6. Treas. Reg. § 301.7701-1(c) (1960). These regulations came as an outgrowth of *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954), which involved a group of doctors who dissolved a partnership and formed an unincorporated association to practice medicine, providing for the characteristics necessary to be classified as a corporation for tax purposes. The Commissioner argued that doctors could not, under state law, practice medicine in an organization which possessed these characteristics, and that since the organization would be treated as a partnership for purposes of liability, etc., the organization should be taxed as a partnership. The court ruled that the doctors could form such an association for income tax purposes even though under state law the association would be treated as a partnership since, according to its own regulations, the IRS was not bound by determinations under local law. In an effort to combat the ruling in the *Kintner* case, the IRS promulgated Treas. Reg. §§ 301.7701-1 to -4.

7. The Professional Corporation Act, S. 73, 92d Ass'ly (1961) was introduced on January 13, 1961, and passed by a vote of 45 to 2 on February 7, 1961. After the bill went to the House of Representatives on February 14, it was referred to committee and subsequent committee amendments altered the bill to such an extent it never reappeared.

The Medical Corporation Act is IND. ANN. STAT. §§ 25-4901 to -4921 (Burns Supp. 1963).

form of organization for conducting business.⁸ This act resembles typical state legislation on business trusts with the exception of one intentionally engrafted provision. The definition section provides:

A "business trust" is an unincorporated business association which is created by a trust instrument, pursuant to common law or enabling legislation, under which property is held, managed, administered, controlled, invested, re-invested, and/or operated, *or business or professional activities for profit are carried on, by a trustee or trustees for the benefit and profit of such person or persons as are or may become the holders of transferrable certificates . . . evidencing beneficial interests in the trust estate. . . .*⁹

If the phrase "business or professional activities for profit" is interpreted to include architects, chiropractors, osteopaths, engineers, doctors,¹⁰ lawyers and certified public accountants, the act is obviously capable of rendering significant tax advantages to these persons should their respective professions sanction the ethics of practicing in business trusts. And there is no question that the act has granted the greatest latitude in meeting both the provisions of the federal tax laws and the ethical problems of each profession. The definition section requires that the trust's purpose be to carry on business and divide profits among shareholders, allows either restricted or unrestricted transfer of interests as well as shareholder limited liability,¹¹ and the act prescribes that the trust instru-

8. IND. ANN. STAT. § 25-4803 (Burns Supp. 1963). Before 1927 the courts seemed to approve of the business trust as it developed in Massachusetts, as a legitimate business form. *Ridge v. State*, 192 Ind. 639, 137 N.E. 758 (1924). However, in *McLaren v. Dawes Sign & Mfg. Co.*, 86 Ind. App. 196, 156 N.E. 584 (1927), the Indiana Appellate Court cast considerable doubt upon the legality of such a business organization, and as a result the business trust was generally considered illegal in Indiana. See generally Brown, *Contractual Limitation of Liability by the So-Called "Massachusetts Trust," under Indiana Law*, 3 IND. L.J. 318, 324 (1927). See also Note, *Professional Associations and Qualified Pension Plans*, 27 IND. L.J. 124, 136 (1962).

9. IND. ANN. STAT. § 25-4802(a) (Burns Supp. 1963) (Emphasis added.) The emphasized phrase was not a part of House Bill No. 1102 as introduced in the General Assembly, but was an amendment recommended by Judiciary Committee "A" of the House of Representatives. The entire bill was rewritten in committee and followed quite closely the Kansas Business Trust Act with the exception of the phrase in question. See KAN. GEN. STAT. art. 20 §§ 17-2027 to -2038 (Supp. 1961).

10. The Medical Corporation Act provides many of the features which are available in a business trust, but it allows less flexibility than does the business trust act. If physicians are included under the business trust act, a practitioner could chose the one best suited to his needs.

11. A "business trust" is an unincorporated business association which is created by a trust instrument . . . under which property is held, managed, administered, controlled, invested, reinvested, and/or operated, or business or professional activities for profit are carried on, by a trustee or trustees for the benefit and profit of such person or persons as are or may become the holders of

ment shall be conclusive of the trust's power and authority to transact business.¹² Because the phrase will, practically speaking, be of no consequence unless professional men can ethically conduct their business in trust form and at the same time secure tax benefits, this note will explore the difficulties encountered in simultaneously meeting both sets of standards. The discussion will concentrate on the ethical problems facing lawyers, but to the extent that other professions face similar ethical structures, it will apply to them as well. But first the phrase "business and professional activities for profit" must be examined to be certain it encompasses attorneys, and the legislature's power to authorize the practice of law in business trusts must be questioned.

I. THE INDIANA BUSINESS TRUST ACT

Interpretation of the Statute

The meaning of the phrase "business and professional activities for profit" is not at once apparent, and the remainder of the statute in no way limits its effect;¹³ its scope must be assessed by a construction of its terms. Because it is commonplace for "business activities" to be carried on in business trust form,¹⁴ the major construction problem is interpret-

transferable certificates . . . which have either restricted or unrestricted transferability. . . . Such business trust may provide that the holders of such certificates are entitled to the same limitation of personal liability extended to stockholders of private corporations for profit.

IND. ANN. STAT. § 25-4802(a) (Burns Supp. 1963).

12. "The power and authority of any business trust authorized under this act to transact business in this state shall be as specified in the instrument by which it was created . . . which instrument shall be construed and interpreted in accordance with the common and statutory law applicable to business trusts." IND. ANN. STAT. § 25-4808 (Burns Supp. 1963).

Certain problems may arise when interpreting the trust instrument in accordance with common and statutory law applicable to business trusts, but these problems will be dealt with in relation to the ethical problems created by the corporate characteristics necessary to satisfy the Internal Revenue Code.

13. The only specific provision of the act which tends to limit the effect of the language used in the definition section is in IND. ANN. STAT. § 25-4808 (Burns Supp. 1963):

No business trust shall engage in the business of operating a rural loan and savings association or credit union or have the power or authority to conduct a banking, railroad, insurance, surety, safe deposits, mortgage guaranty, or building and loan business, or in the business of mining or manufacturing, or in any business regulated under the Public Service Commission of Indiana, or take any action which is in violation of this act.

On its face this provision does not appear to limit the term "professional activities" in any manner, but is directed solely toward business activities. Supporting this interpretation of the provision's application to business activities is the presence of these same restrictions on domestic and foreign corporations. IND. ANN. STAT. § 25-201 (Burns 1960), and IND. ANN. STAT. § 25-302 (Burns Supp. 1963).

14. Annot., 156 A.L.R. 21, 81 (1945). Examples of business activities conducted in trusts are petroleum refining, mercantile business, restaurants, laundries, motion picture production, newspapers, summer resorts and livestock trading.

ing "professional activities."

It could be argued that the statute was not intended to apply to the traditional professions recited in the 1961 Professional Corporation Act, *i.e.*, to lawyers, doctors, certified public accountants, etc.,¹⁵ because these have been historically described as activities of public service, not of "profit."¹⁶ But the argument would have little to commend it; there are several plausible explanations for use of the words "for profit" which indicate they were not intended to preclude the statute's application to the traditional professions. First, the general corporation act categorizes corporations as either "for profit" or "not for profit."¹⁷ A "not for profit corporation" is one which "does not engage in any activities for the profit of its members and is organized and conducts its affairs for purposes other than the pecuniary gain of its members."¹⁸ Even if attorneys encountered no ethical problems by practicing law in corporate form, it is obvious that they could not meet the requirements of a "not for profit corporation," and it would make no more sense to say that their practice is an activity "not for profit." Moreover, if the traditional professions are excluded from those which can form business trusts solely because their primary motive is public service, they would also be unable to practice law under a partnership agreement since the uniform act defines a partnership as "an association of two or more persons to carry on as co-owners a business *for profit*."¹⁹ It seems clear that a major reason for the words "for profit" was simply to exclude traditional non-profit activities from the act.²⁰ Second, the drafters might

15. "'Professional Service' means any type of professional service which may be legally performed only pursuant to a license or other legal authorization, *e.g.*, the personal service rendered by certified public accountants, chiropractors, dentists, osteopaths, physicians and surgeons, attorneys at law and life insurance agents." S. 73, 92d Ass'by (1961).

16. When we speak of the recognized professions . . . we mean an organized calling in which men pursue a learned art and are united in the pursuit of it as a public service—as I have said, no less a public service because they may make a livelihood thereby. Here from the professional standpoint there are three essential ideas—organization, learning, and a spirit of public service. The gaining of a livelihood is not a professional consideration. Indeed, the professional spirit, the spirit of public service, constantly curbs the urge of that instinct.

Address by Dean Roscoe Pound, Nebraska State Bar Association, October 20, 1949 in *Re Rothman*, 12 N.J. 528, 548, 97 A.2d 621, 631 (1953).

17. IND. ANN. STAT. § 25-101 to -723 (Burns 1960).

18. IND. ANN. STAT. § 25-507(d) (Burns 1960).

19. IND. ANN. STAT. § 50-406 (Burns 1951) (Emphasis added.)

20. This conclusion is substantiated by the filing fees which are to be charged a business trust in Indiana. Business trusts are required to pay a fee of two cents for each one hundred dollars of the corpus of the trust and must pay an additional filing fee of six dollars. In no case can the application fee be less than twenty dollars. IND. ANN. STAT. § 25-4805 (Burns Supp. 1963). A domestic corporation for profit must pay a filing fee of two cents per share on the first twenty thousand shares and two

have thought that using the words "for profit" would help secure the desired tax benefits.²¹ As seen above, an essential characteristic of any organization for taxation as a corporation is an objective to engage in business for profit.²² The drafters perhaps felt a failure to require business trusts to organize for profit could result in their taxation as regular trusts, rather than as corporations.²³

To say "professional activities for profit" embraces conventional professions, *e.g.*, the legal profession, does not fully delineate the phrase. The Indiana General Assembly could have intended "professional" to depict not only traditional professions, but any vocation in which the work is predominantly intellectual rather than physical.²⁴ It is doubtful however that such a construction would be justified, for it presumes that business activities for profit can be differentiated from professional activities for profit. The distinction is virtually impossible to make. Professional activities whose primary goal is to gain profit, such as business consultants, authors, psychologists, economists or artists, to mention a few, are most appropriately termed business activities, and the term "professional" would therefore be redundant in part. If "professional" is given the narrow interpretation, a business trust could be formed for either of two distinct types of activity. Indeed, sound construction alone requires the elimination of the redundancy, and allows both "business" and "professional" to modify "activities for profit."

cents per share on all additional shares. This minimum fee is also twenty dollars. IND. ANN. STAT. § 25-702 (Burns 1960). The fees charged a not for profit corporation differ substantially from those charged the domestic corporation for profit and the business trust in that a flat fee of ten dollars must be paid. IND. ANN. STAT. § 25-602(a) (Burns 1960).

21. See note 2 *supra*.

22. Treas. Reg. § 301.7701-2(a)(2) (1960).

23. *Ibid.* In Treas. Reg. § 301.7701-2(g) a number of examples illustrate the requisite characteristics for classification as an association. Examples 1, 2, & 3 deal with organizations of doctors or lawyers. All three specifically mention that the purpose of the organization is to furnish, *for profit*, medical or legal services to the public and then conclude that the associations "have an objective to carry on business and divide the gains therefrom." Simply because the Indiana Business Trust Act provides that all business trusts formed must be "for profit" does not mean that the Commissioner of Internal Revenue will consider the terms of the Indiana Business Trust Act conclusive on the subject. On the other hand, if that act requires that all trusts be organized for profit, a business which can comply with the Indiana statute can also comply with the Treasury Regulations. Furthermore, since local law plays such an important role in determining whether the requirements of the Treasury Regulations are met, Treas. Reg. § 301.7701-1(c) (1960), the professions whose primary aim is to provide a public service and not to gain profit may argue that the acceptance of the instrument for recording establishes that the business trust was formed for the objective of gaining profit; otherwise the instrument would not have been accepted.

24. A profession may be defined as "a vocation, calling, occupation or employment involving labor, skill, education, and special knowledge . . . but the labor and skill is predominantly mental or intellectual, rather than physical or manual." BLACK, LAW DICTIONARY (4th ed. 1951).

Legislative Power to Permit Practice of Law in Business Trust Form

Regardless of the legislature's intention, its efforts to secure tax benefits for the legal profession are for naught if that is the sole prerogative of the judiciary. An oft-quoted opinion of the Supreme Court of Massachusetts is that "it would not be within the competence of the [legislature] . . . to enact legislation designed to permit [the] . . . practice of law 'by corporations or associations or by individuals other than members of the bar of the Commonwealth.'"²⁵ The main theme of this pronouncement seems to be that the legislature may not usurp the power of the judiciary by prescribing who may be eligible to practice law, or in what business form they can ethically practice. And, the opinion seems entirely in harmony with the almost unanimously recognized fact that control of court officers is one of the judiciary's inherent and exclusive prerogatives through the doctrine of separate and implied powers.²⁶ Traditionally, and in Indiana, courts have prohibited lawyers from practicing in corporate form,²⁷ and it might be thought that this traditional pro-

25. Opinion of the Justices, 289 Mass. 607 (1934).

26. "It is inherent in the judicial department of government under the Constitution to control the practice of the law, the admission to the bar of persons found qualified to act as attorneys at law, and the removal from that position of those once admitted and found to be unfaithful to their trust." Opinion of the Justices, 289 Mass. 607 (1934). See also *People v. Goodman*, 366 Ill. 346, 8 N.E.2d 941 (1937). For an excellent article on the subject, reflecting in particular Indiana law, see Dowling, *Inherent Power of the Judiciary*, 11 IND. L.J. 116 (1935). Only two states have denied the existence of the inherent power of the judiciary—New York and Florida. *In re Cooper*, 22 N.Y. 67 (1860); *Petition of the Florida Bar Association*, 145 Fla. 223, 199 So. 57 (1940); *Barr v. Watts*, 70 S.2d 347 (Fla. 1953). As a result of the cases in Florida a constitutional amendment to that state's Constitution was proposed and adopted in the General Election of 1956. It provided that "the supreme court shall have exclusive jurisdiction over the admission to the practice of law and the discipline of persons admitted." FLA. CONST. art. 5 § 23.

For the rationale of the power see *People v. Goodman*, 366 Ill. 346, 8 N.E.2d 941, 944 (1937). "The power to regulate and define the practice of law is a prerogative of the judicial department as one of the three divisions of the government created by article 3 of our Constitution." *Accord, Ex parte Leach*, 134 Ind. 665, 667 (1893); Dowling, *supra* at 120, 124.

27. For leading cases where the practice of law by a corporation was prohibited see *In re Co-operative Law Co.*, 199 N.Y. 479, 92 N.E. 15 (1910); *People v. Merchants Protective Corp.*, 189 Cal. 531, 209 Pac. 363 (1922); *State ex rel. Lundin v. Protective Corp.*, 105 Wash. 12, 177 Pac. 694 (1919).

As to Indiana particularly see *Groninger v. Fletcher Trust Co.*, 220 Ind. 202, 41 N.E.2d 140 (1942), where the supreme court, although not necessary to the decision of the case, held that "the practice of law is restricted to natural persons who have been licensed upon the basis of established character and competence as a protection to the public against lack of knowledge, skill, integrity, and fidelity." *Id.* at 207. Under the Indiana Constitution courts are vested with the complete judicial power of the state. The constitution provides that "the judicial power of the State shall be vested in a Supreme Court, in Circuit Courts and such other courts as the General Assembly may establish." Ind. Const. art. 7 § 1. Article 3 § 1 of the Indiana Constitution provides, "The powers of Government are divided into three separate departments; the Legislative, the Executive including the administrative, and the Judicial; and no person charged with official duties under one of the three departments, shall exercise any of the functions of

hibition could be extended to business trust practice by Opinion 283 of the American Bar Association Committee on Professional Ethics and Grievances (ABA Committee).²⁸

But though the power to regulate attorneys resides in the courts, and they exercise that power through rules of procedure, the two remaining departments of state government are not precluded from adopting measures which affect attorneys. In exercising its police power the legislature may prescribe the permissible organizational forms for intrastate business, regardless of whether lawyers are affected.²⁹ The legislature has an even more immediate interest in the practice of law than simply regulating organizational structures, since other state residents are directly affected by a lawyer's legal competency. Thus, laws are passed which prescribe punitive measures for the unauthorized practice of law and exclude certain public officials from the practice.³⁰ The legislature therefore indirectly, if not directly, regulates the legal profession without unconstitutionally intruding upon the judicial prerogative.³¹ In fact, the state's legislative and judicial departments have a concurrent interest in

another except as in this Constitution expressly provided." Prior to 1931 the constitution provided that every person of good moral character who was a voter was entitled to practice law, IND. CONST. art. 3 § 21 (1854), and some attorneys have argued that because of this provision the courts never have had exclusive power to regulate the practice of law. In 1931 this section of the constitution was repealed by a referendum vote, and a statute was passed granting the courts exclusive authority to regulate the practice of law. IND. ANN. STAT. § 4-3605 (Burns 1933). It could be argued that the courts have never possessed the right to regulate the practice of law except through the grant of the legislature, and that the Indiana Business Trust Act has modified that grant of power in allowing lawyers to practice law in a business trust. Such an argument tends to misconstrue the original provisions of article 3, section 21 of the constitution. That section referred only to the right to admission to the bar. Even though a voter was entitled to practice law, the court could examine one's character before admission or it could, once an attorney was admitted, prescribe rules of conduct and institute disciplinary proceedings against him. See *State ex rel. Hovey v. Noble*, 118 Ind. 350, 21 N.E. 244 (1888).

As a necessary corollary to the judicial power the doctrine of implied powers confers upon the judiciary the power to regulate matters pertaining to the courts, including regulation of its officers. *In re Cate*, 273 Pac. 617, 620 (Cal. Dist. Ct. App. 1928); *Dowling*, *supra* note 26, at 120 and cases cited therein.

28. "It is not professionally proper for a group of associates to practice law when some are trustees of a common law trust and all are beneficiaries." ABA COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES, *Opinion 283*, in *CANONS OF PROFESSIONAL AND JUDICIAL ETHICS, OPINIONS OF COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES* 596 (1957).

29. Lawyers probably could not form a partnership violating the Uniform Partnership Act in Indiana and still have that organization recognized as a partnership.

30. For examples of statutes which have been enacted to assist the judiciary in its control over the practice of law see IND. ANN. STAT. §§ 4-3601, -3602 (Burns 1933), defining the unauthorized practice of law and prescribing penalties for such practice, and IND. ANN. STAT. §§ 10-3107, -3108 (Burns 1956), prohibiting municipal judges from practicing law and prohibiting the encouragement of law suits.

31. See *In re Harrison*, 231 Ind. 665, 109 N.E.2d 722 (1953); *People v. Goodman*, 366 Ill. 346, 8 N.E.2d 941, 944 (1937); *Opinion of the Justices*, 289 Mass. 607, 612 (1934).

the practice of law, and both strive for an effective judicial system. The judicial department establishes ethical standards of conduct for attorneys; the legislature exacts their adherence to proper organizational structure and provides punitive measures to insure that proper conduct is observed.

Returning to the admonition of the Massachusetts Supreme Court against legislative usurpation of judicial regulatory powers, it is clear that the Indiana Business Trust Act has not attempted such a usurpation. The terms of the act are permissive.³² It merely recognizes the trust as a legitimate business form for the professions and does not address itself to the ethical propriety of business trust practice. Thus, the question has been left to the individual professions and, in the case of lawyers, to the judiciary.

II. TAX AND ETHICAL CONSIDERATIONS OF PRACTICING LAW IN BUSINESS TRUSTS

Although various reasons have been advanced for prohibiting the practice of law in corporate form, the most frequent is that to do so would violate the ethics of the legal profession. Virtually all opinions that such practice is a violation of professional ethics were rendered prior to the enactment of those statutes which allow the formation of professional corporations or associations.³³ As a result of these enactments several inquiries were directed to the ABA Committee concerning the ethical propriety of forming organizations to practice law, to which it replied:

[T]he substance of an agreement is controlling, not the form. In other words, the mere fact that the form of organization used by lawyers to practice law is a professional association (other than the orthodox partnership) or is a professional corporation does not in and of itself constitute a violation of any Canon. A look behind the form to the substance is required to ascertain whether any Canon is violated.³⁴

The committee explained the real question is whether lawyers can practice in business organizations which permit limited liability, centralized management, free transferability of interests and continuity of life with-

32. IND. ANN. STAT. § 25-4803 (Burns Supp. 1963).

33. Opinion 283 of the American Bar Association Committee on Professional Ethics and Grievances was rendered in 1950, but professional corporations and associations did not come into vogue until approximately 1958. The major portion of acts allowing professional practitioners to form corporations have been enacted since 1960.

34. ABA Committee on Professional Ethics and Grievances, *Opinion* 303, 48 A.B.A.J. 159 (1961).

out violating the Canons of Professional Ethics.³⁵ To analyze these, the secondary characteristics of corporate existence, and the canons, it is assumed:

1. A group of lawyers join together and supply capital for a trust.
2. From the group a smaller number is designated to serve as trustees.
3. Certificates of beneficial interests are issued to all members.
4. The lawyer-members are employed by the trust to perform legal services as they would in an orthodox partnership.

Limited Liability

The Treasury Regulations explain that an organization has limited liability when "under local law there is no member personally liable for the debts or claims against the organization."³⁶ By contrast, in an organization like a general partnership created under a statute similar to the UPA which has unlimited liability, each member is liable not only for claims against himself, but also for those against the organization of which he is a member if the assets of the organization are insufficient to satisfy the claims of creditors. This is so regardless of the nature of the claim and of any personal wrong on the part of the member.³⁷ Thus, to change from unlimited to limited liability, the second feature of a member's liability must be eliminated.

It would at first thought seem unquestionable that a professional business trust could possess the characteristic of limited liability. Under the Indiana Business Trust Act, *i.e.*, "local law," a trust instrument may provide for the same limitation of personal liability afforded stockholders

35. *Ibid.*

36. Treas. Reg. § 301.7701-2(d)(1). Proposed Treas. Reg. § 301.7701-2(h)(4), 28 Fed. Reg. 243 (1963) reads as follows:

A professional service organization has the corporate characteristic of limited liability within the meaning of paragraph (d) of this section only if the personal liability of its members is not greater in any aspect than that of shareholder-employees of an ordinary business corporation. If under local law and the rules pertaining to professional practice, the liability of a professional person to the clients or patients of the professional service organization is more extensive than the personal liability of a shareholder-employee of an ordinary business corporation to its customers or patrons, the professional service organization lacks the corporate characteristic of limited liability.

If this addition is adopted, it does not appear that any substantial alteration will be made in the regulations as they now exist.

Under the INT. REV. CODE OF 1954, § 7701(8), "the term 'shareholder' includes a member in an association, joint-stock company, or insurance company."

37. ABA Section of Taxation, *Report of the Special Committee to Cooperate with ABA Committee on Professional Ethics Re Associations of Attorneys Taxable as Corporations*, ABA Taxation Bull., Oct. 1961, p. 41, at 51.

of private corporations for profit.³⁸ Moreover, under the common law of business trusts, members are immune from personal liability.³⁹ Thus if a business trust instrument provided that each lawyer-employee was liable without limit for his own professional conduct including contract,⁴⁰ and was not personally liable for claims against the trust which had no reference to his personal activities, this would permissibly limit liability and satisfy the Treasury Regulations. But a question arises from the requirement that trustees, who must be beneficiaries, may be liable for some debts of the trust.

A business trust instrument may effectively exempt trustees from personal liability for the *contractual* claims and obligations of the trust if the terms of the instrument become an integral part of the contracts entered into by the trustees for the organization.⁴¹ The instrument cannot, however, exempt a trustee from personal liability for *torts* committed by an employee of the trust, and it is irrelevant whether the tort was com-

38. IND. ANN. STAT. §§ 25-4802(a) and 25-4808 (Burns Supp. 1963).

39. Annot., 156 A.L.R. 22, 107 (1945). "Where trustees of a business trust are vested with title to the trust property and with the exclusive power to manage and conduct the affairs of the trust . . . the shareholders are not personally liable for the debts or contractual obligations incurred by the trustee on behalf of the trust." The courts seem to apply the same tests and principles to determine the liability of shareholders of a business trust for torts. *Id.* at 113.

The common law of business trusts referred to throughout the remainder of this note constitutes the common law of business trusts as it has developed in Massachusetts and states which have followed the precedents of the Massachusetts courts: Such reference can be justified on three grounds: (1) The business trust originated in Massachusetts without enabling legislation and has reached its fullest development and most extensive use in that state. Annot., 156 A.L.R. 22, 29 (1945); (2) Even though statutes have been passed in Massachusetts concerning the business trust, these have been designed to achieve state control over taxation and registration and have not affected or changed the substantive law of business trusts. (See MASS. ANN. STAT. ch. 182 §§ 1 to 14 (Supp. 1962)); (3) The rules of substantive law developed in Massachusetts form a substantial majority position. Even though a few states have declined to follow the precedents of the Massachusetts courts, they have felt obliged to acknowledge this majority position and then reject it. For a discussion of the position of authority which Massachusetts has held in formulating the common law rules of business trusts see Jones, *Business Trusts in Florida—Liability of Shareholders*, 14 U. FLA. L. REV. 1 (1961).

40. Ordinarily an agent is not liable for the contractual obligations of the principal but, according to Mechem, the agent and the principal may alter the terms of liability in any manner they desire. MECHEM, AGENCY § 297 (4th ed. 1952).

41. The personal liability of the trustees of a business trust may be limited by provision to that effect in the declaration of trust, if known and agreed to by all the parties affected. . . . A provision of the trust instrument that persons contracting with the trustees shall look to the trust property and not to the trustees individually for the payment of any debts or obligations is held to have the effect of exempting the trustee from individual liability under a contract which he executed in his capacity as trustee, to one who was charged with notice of the provision in the trust instrument.

Annot., 156 A.L.R. 22, 174 (1945). Under the Indiana Business Trust Act persons dealing with the trust are charged with notice of the provisions of the trust instrument, so that in the absence of particular ethical prohibitions, a trustee-member could be exempted from contractual liability. See IND. ANN. STAT. § 25-4808 (Burns Supp. 1963).

mitted intentionally, negligently or without the fault of the trustee.⁴² To exempt a trustee from personal liability for employee torts would sanction an avoidance of the master-servant rule, and thus violate public policy.⁴³ Because a member of every business trust would be subject to personal liability, albeit as a trustee and not as a member, the question is whether the Treasury Regulations could translate this fact into the characteristic of unlimited liability. Apparently neither the courts nor the IRS have been troubled with the feature of a trustee's tort liability; the regulations specifically state that limited liability is a characteristic generally common to both trusts and corporations,⁴⁴ and although no decisions have been rendered by the courts under the 1960 regulations, the Supreme Court ruled in *Morrissey v. Commissioner*⁴⁵ that the business trust there involved possessed limited liability although its shareholders served as trustees and were subject to tort liability.⁴⁶

There is good reason to believe that the IRS will follow the line of decisions handed down before the promulgation of the current regulations.⁴⁷ First, though the liability of business trusts is not completely

42. *Fisheries Co. v. McCoy*, 202 S.W. 343 (Tex. Civ. App. 1918). This case is the only one which has ruled on the trustees' liability for acts of agents in a business trust where the creating instrument purported to exempt the trustee from liability. The concept of trustee liability was adopted from regular trust law as set forth in RESTATEMENT (SECOND), TRUSTS § 264, comments *b* and *d* (1959):

Under the principle of respondeat superior, torts committed by the agents or servants of the trustee in the course of administration subject the trustee to liability to the same extent as though he were not trustee. . . . A provision in the terms of the trust that the trustee shall not be personally liable for torts committed in the administration of the trust is not effective to relieve the trustee of liability.

The discussion of *Fisheries Co. v. McCoy*, *supra*, in Annot., 156 A.L.R. 22, 178 (1945) implies that the rule adopted is not authority for business trust law since business trusts are treated as partnerships in Texas. However, the Texas courts did not treat the business trust as a partnership until three years after the case was decided. Other writers have considered the decision of the Texas case as good precedent for trustee liability in a business trust. See, e.g., Hildebrand, *Liability of Trustees, Property and Shareholders of A Massachusetts Trust*, 2 TEXAS L. REV. 139 (1934), where the writer asserts that "clearly the provision that the trustees shall not be liable for their own torts, nor those of their agents, is nugatory." *Id.* at 149. "For this reason in every declaration of trust a provision should be inserted authorizing the trustees to pay for insurance against such tort liability as they can obtain, out of trust assets." *Id.* at 145. See also WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION 860 (1929).

43. *Fisheries Co. v. McCoy*, *supra* note 42.

44. Treas. Reg. § 301.7701-2(a) (2) (1960).

45. 296 U.S. 344 (1935).

46. *Id.* at 361.

47. *Rohrer v. United States*, 275 F.2d 120 (9th Cir. 1960); *Scotfield's Estate v. Commissioner*, 266 F.2d 154 (6th Cir. 1959); *Reynolds v. Hill*, 184 F.2d 294 (8th Cir. 1950); *Titus v. United States*, 150 F.2d 508 (10th Cir. 1945); *United States v. Hill*, 142 F.2d 622 (10th Cir. 1944); *Keating-Snyder Trust v. Commissioner*, 126 F.2d 860 (5th Cir. 1942); *Sears v. Hasset*, 111 F.2d 961 (1st Cir. 1940); *Pelton v. Commissioner*, 82 F.2d 473 (7th Cir. 1936); *Fowler v. United States*, 69 F. Supp. 528 (E.D. Mo. 1947).

limited, it more closely resembles limited than unlimited liability. The regulations recognize that the characteristic of transferability of interests may take a modified form, and although the conclusion certainly could not be termed irresistible, the IRS may allow the same modification of limited liability.⁴⁸ For the most part the trust is a separate entity, liable as such, and the trustee's liability is only make-weight. Liability is not an incidence of full and active ownership, so tax treatment of the organization as an independent taxable unit is justified. Second, the cases show that it has been the Treasury Department, not the taxpayer, that has most frequently demanded that an organization be classified as an association. On these occasions the government has assessed a tax on the shareholders and a delinquency against the "corporation." To rule that limited liability does not exist in a business trust would make it more likely that no trust would qualify as an association. Certainly the enactment of professional corporation and association statutes will result in an increase in the number of organizations seeking classification as associations. In that event it is probable that the loss of revenue through increased benefits which would result from that classification would not approach the loss from a ruling that business trusts have unlimited liability, and thus are taxable as a partnership. The most logical prediction as to the position which the IRS and the courts will take is that the personal tort liability of a trustee who is also a member of the business trust would not destroy the characteristic of limited liability.

In considering the ethical propriety of practicing law with limited liability, the most relevant question is not whether a lawyer may avoid personal liability for his own conduct, for it is settled that he cannot, but whether he can limit his liability for claims against the organization which arise, *e.g.*, from the personal misconduct of associates.⁴⁹

Canon 33 of the Canons of Professional Ethics specifically approves the partnership practice of law,⁵⁰ but the canon's history negates any inference that the partnership is the only permissible form for practice. The canon was adopted to make it clear that American lawyers, unlike the English barristers who had not been allowed to practice in any

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

49. ABA Section of Taxation, *Report of the Special Committee to Cooperate with ABA Committee on Professional Ethics Re Associations of Attorneys Taxable as Corporations*, ABA Taxation Bull., Oct. 1961, p. 41, at 51; California State Bar Association, *Incorporation of Law Offices—Summary of Report of Special Committees*, 37 CALIF. S.B.J. 473 (1962).

50. ABA CANONS OF PROFESSIONAL ETHICS, Canon 33 (1928) provides in part, that "partnerships among lawyers for the practice of their profession are very common and are not to be condemned."

type of organization, could associate to practice law.⁵¹ Indeed the ABA Committee has concluded it is not unethical to practice law under an organizational structure embodying limited liability, provided each lawyer rendering legal services is personally responsible to his client, and restrictions on the liability of other lawyers in the organization are made apparent to the client.⁵² The necessary inference of the committee's pronouncement is that partnership law, not ethical standards, imposes joint and several liability. Therefore, a business trust instrument which provides that each lawyer-employee is liable without limit for his own professional conduct in all dealings would meet the ethical requirements of the legal profession.⁵³

If there is no ethical objection to limited liability itself, it is submitted that all other arguments against such liability which go to its effect and are based on a general concept of legal ethics can be satisfied either by the trustees' personal tort liability, or by providing in the trust instrument or requiring by state rule or statute that the business trust maintain lawyer professional liability insurance.

The requirement for professional liability insurance would not be an innovation. A Colorado Supreme Court rule requires all members of a lawyer's corporation to be jointly and severally liable, except where the corporation maintains lawyer professional liability insurance in accordance with certain minimum standards.⁵⁴ As might be expected many object to compulsory liability insurance for the reasons that the lawyer loses his right to determine the merit of a claim, the insurance company receives the credit for paying the claim, insurance creates the impression that lawyers need to be insured through a fear of valid claims and insurance companies may pay questionable claims which would erroneously reflect upon the competence of the insured.⁵⁵ It should be pointed out

51. DRINKER, *LEGAL ETHICS* 203, 204 (1953).

52. ABA Committee on Professional Ethics and Grievances, *supra* note 34, at 160. The opinion discussed limited liability in connection with the ethical requirements of a direct and personal relationship between attorney and client, an organization name which would not be misleading, and of dividing fees between lawyers based on professional responsibility.

53. *Ibid.*

54. Colo. Sup. Ct. (Civ.) R. ch. 19 § 231G requires professional corporations to provide professional liability insurance in amounts of fifty thousand dollars for each claim multiplied by the number of attorneys employed by the corporation. As an alternative a professional corporation may provide for an aggregate amount of insurance of one hundred fifty thousand dollars multiplied by the number of attorneys serving the organization. In no case, however, does the insurance need to exceed three hundred thousand dollars per claim nor more than nine hundred thousand dollars a year aggregate.

55. See Sterling, *A Debt of Honor*, 35 CALIF. S.B.J. 243 (1959); Curran, *Professional Negligence: Some General Comments*, in *PROFESSIONAL NEGLIGENCE* 9 (Roady & Andersen ed. 1960); Hirsh, *Medical Malpractice Insurance*, in *PROFESSIONAL NEGLIGENCE* 144 (Roady & Andersen ed. 1960).

that some of these objections are not solely applicable to professional liability insurance, but rather apply to any type of insurance. The validity of these arguments must be balanced against the desirability of having all lawyers adequately protected so that, in turn, the rights of the client are secure.⁵⁶

For those lawyers who consider compulsory liability insurance objectionable, the fact that trustees who are normally the senior and most affluent members of the firm have unlimited liability for the employee torts, when added to the accessibility of the trust assets, should provide adequate safeguards for the interests of persons dealing with professional business trusts. Opinion 303 of the ABA Committee requires only that restrictions on the liability of other lawyers in the organization be made apparent to the client.⁵⁷

How does the existence of compulsory insurance or trustee tort liability affect the arguments leveled at the effects of limited liability? One of the most frequently voiced objections to limited liability is that it may shelter unscrupulous practitioners from liability in malpractice suits.⁵⁸ Such a consequence is highly improbable. If a business trust attorney engaged in misconduct while representing a client he would be personally liable under the trust instrument.⁵⁹ Although an insurance company might absorb the pecuniary loss in the event the trust carried liability insurance, the attorney would nevertheless be subject to proper disciplinary action by the state bar association. Moreover, if the dishonorable practitioner were a trustee of the business trust, he would be personally liable in his trustee capacity. Finally, it might be thought that a lawyer could find shelter from liability behind a business trust by conceiving of a method to manage the trust without being trustee. Such a scheme would not succeed for the characteristic of centralized management would be

56. It is not within the scope of this note to weigh the respective advantages and disadvantages of compulsory liability insurance for all lawyers practicing law in business trusts, but merely to point out to those advocates of compulsory insurance some of the arguments which would have to be overcome before a plan of compulsory insurance could be adopted.

57. ABA Committee on Professional Ethics and Grievances, *supra* note 34, at 160. The opinion does not disclose how this limitation is to be made apparent to clients. It is possible that it can be accomplished by including such letters as "Inc.," "P.A." (Professional Association) or "S.C." (Service Corporation) on all letterheads, contracts of employment and billings. Initially, however, it is doubtful that the public would be familiar enough with any designation except "Inc." to put them on notice of limited liability. Thus, clients would have to be informed of that fact by the lawyer serving them.

58. Jones, *Should Lawyers Incorporate?*, 11 HASTINGS L.J. 150 (1959).

59. See the recommended provision for an attorney's liability for his own conduct at note 40 *supra* and accompanying text. Such a provision interpreted in accordance with IND. ANN. STAT. § 25-4808 (Burns Supp. 1963), would impose personal liability on an attorney for any misconduct.

lost, the trust treated as a partnership and all its members subject to unlimited liability.⁶⁰ And where influence instead of control is used to improper ends, there always exists the threat of disbarment.⁶¹

The three remaining arguments against business trust practice because of limited liability can also be discounted. The first is that a client's contract would be with the business trust rather than the individual lawyer, and hence the latter would not be personally liable for his conduct.⁶² If privity of contract does make a difference in the obligation of the lawyer toward his client, although this is extremely doubtful,⁶³ the trust instrument provision that all lawyer-employees are personally liable in both contract and tort would preclude them from successfully asserting freedom from liability.⁶⁴ Second, it has been contended that negligence or misconduct would be more difficult to prove where a business trust is involved.⁶⁵ In answer it can only be said that proving the negligence or misconduct of a lawyer has always been difficult,⁶⁶ in large measure be-

60. In most jurisdictions shareholders of a business trust are not liable for trust debts provided that they are neither vested with nor exercise substantial control over the business of the trust. Jones, *Business Trusts in Florida—Liability of Shareholders*, U. FLA. L. REV. 1, 17 (1961); Annot., 156 A.L.R. 22, 112 (1945). Because directing the efforts of lawyers within a business trust is one of the primary duties of the trustees, the usurpation of this authority by a non-trustee would allow a shareholder to control the business and destroy the feature of limited liability. For a general discussion of the "control test" in determining the liability of shareholders, see Annot., 156 A.L.R. 22, 42 (1945).

61. ABA CANONS OF PROFESSIONAL ETHICS, Canon 29 (1908) provides in part that "lawyers should expose without fear or favor before the proper tribunals corrupt or dishonest conduct in the profession, and should accept without hesitation employment against a member of the Bar who has wronged his client." This canon should serve as a partial guard against non-trustees influencing other members of a business trust since Canon 29 has been interpreted to require a lawyer-employee to report any questionable or unethical conduct of associates or superiors and to withdraw from that particular firm if necessary. NEW YORK COUNTY BAR ASSOCIATION, *Opinion 78*, in DRINKER, *LEGAL ETHICS* 60 n.2 (1953).

62. Jones, *supra* note 58.

63. In one of the first reported cases in this country when a defendant in a malpractice suit asserted that unless there was a binding contract, he did not owe the plaintiff the duty of counsel, Judge Roane replied: "The most complete answer . . . is that the appellee undertook to conduct the suit, and in his management of it was guilty of such a neglect of his duty as to subject the plaintiff to a loss; after this it is not competent to him to allege a want of consideration." *Stephens v. White*, 2 Wash. 203, 210 (Va. 1796).

64. See note 40 *supra*.

65. Note, 75 HARV. L. REV. 776, 789 (1962). "Where more than a single lawyer works on a client's problem, the client may have extreme difficulty in proving that any particular one was negligent." See also, Bitker, *Professional Associations and Federal Income Taxation: Some Questions and Comments*, 17 TAX L. REV. 1, 10, 11 (1961).

66. In order to recover in a negligence action against an attorney it is necessary to show that his negligence was the cause of legal damage to the client. . . . It is in connection with negligence in the conduct of litigation that the question of causation has presented its most difficult problems. Here the rule was developed that when the client lost his case he must show not only that the attorney was negligent but also that the result would have been different except for the

cause the doctrine of *res ipsa loquitur* has been held inapplicable to legal malpractice claims,⁶⁷ and business trust practice should create no unique problems of discovery or proof. Finally, the concept of limited liability might seem opposed to the profession's recent movement toward self-assumed responsibility for the competence and conduct of all its members. Since 1955 the ABA has maintained a committee to study and promote the creation of clients' security funds to compensate those who have suffered loss through the conduct of negligent, incompetent or dishonest lawyers.⁶⁸ The rationale for these funds is that lawyers want the general public to consider all members of the profession competent and trustworthy; and, when losses are wrongfully visited on clients, lawyers should take collective action to recapture the public's faith in their profession.⁶⁹ In view of the requirement that restrictions on the liability of associates be made apparent to the client,⁷⁰ one may ask whether lawyers who form business trusts have impliedly disavowed their faith in fellow practitioners. The answer to that proposition is that limiting liability to gain tax equality is not incompatible with professional responsibility. Each lawyer seeking tax equality merely exchanges a personal tort responsibility for the obligation to contribute to client protection funds.

From this entire discussion of limited liability it is reasonable to conclude that the liability of the trust, when added to the tort liability of

negligence. In other words, this involves a "suit within a suit," and the client must show that he would have won the first suit as one step in order to win the second one.

Wade, *The Attorney's Liability for Negligence*, in PROFESSIONAL NEGLIGENCE 231 (Roady & Andersen ed. 1960).

67. Priest v. Dodsworth, 235 Ill. 613, 617, 85 N.E. 940, 942 (1909):

In a suit by a client against his attorney for damages charged to have resulted from the negligent management of business, the burden is on the plaintiff to prove the negligence charged. There is no presumption that an attorney has been guilty of a want of care arising merely from his failure to be successful in an undertaking. On the contrary, he is always entitled to the benefit of the rule that every one is presumed to have discharged his duty, whether legal or moral, until the contrary is made to appear. In a suit against an attorney for negligence the burden is therefore on the plaintiff to allege and prove every fact essential to establish defendant's duty and a violation of it.

Cited with approval in *Olsen v. North*, 276 Ill. App. 457 (1934). See also *Pennington Ex'rs. v. Yell*, 11 Ark. 212, 228 (1850); 7 AM. JUR. *Attorneys at Law* § 188 (1963).

On occasion courts have relied upon the inapplicability of *res ipsa loquitur* in negligence actions against attorneys to justify not applying *res ipsa* in malpractice claims against doctors. *Paulich v. Nipple*, 104 Kan. 801, 180 Pac. 771 (1909). Although some courts have made exceptions to this rule in the case of doctors, *Ybarra v. Spangard*, 25 Cal.2d 486, 154 P.2d 687 (1954), no cases were discovered where the doctrine of *res ipsa loquitur* has been applied to lawyers.

68. *Sterling*, *supra* note 55, at 244.

69. *Id.* at 104.

70. ABA Committee on Professional Ethics and Grievances, *supra* note 34, at 160. For a discussion of how this limitation might be made apparent to clients see note 57 *supra*.

trustees or a combination of trustees' tort liability and maintenance of professional liability insurance, can adequately resolve the ethical objections to limited liability in a business trust.

Centralized Management

It is a difficult question whether a lawyer's business trust could ethically possess the characteristic of centralized management required by the Treasury Regulations, as that trait is conceived by the Internal Revenue Service. But the even more fundamental question of whether an organization of attorneys could be so centrally managed as to satisfy the common law of business trusts must first be resolved.

Business trust law requires trustees to exclusively manage their trusts, and if a non-trustee member usurps the management power, the organization is thereafter deemed a partnership.⁷¹ This common law rule has been said to allow trustees to delegate only duties of a ministerial or nondiscretionary nature to agents or servants, while requiring them to retain exclusive authority to perform all discretionary acts.⁷² Of course, if this statement accurately delineates the exclusive management requirement, lawyers could never organize in business trust form; virtually all acts performed by non-trustee members would require some discretion because of the very nature of professional conduct. But authorities have said that the absence or presence of discretion is not solely determinative of the power to delegate a particular function to employees.⁷³ Professor Bogert is of the opinion that courts have in actuality asked only whether the particular delegation would have been made by a reasonably prudent man under similar circumstances,⁷⁴ and the *Restatement of*

71. See note 60 *supra*.

72. It should be noted that the common law rules as to centralized management and delegation of discretionary functions are separate and distinct. Thus, allowing a non-trustee shareholder to perform managerial functions would not violate the common law proscription against delegation of discretionary functions since that rule exists solely for the protection of the beneficiaries. 2 BOGERT, TRUSTS AND TRUSTEES § 555 (2d ed. 1960). Nevertheless, the general strictures of the delegation doctrine are helpful in delineating the scope of the centralized management requirement.

73. 2 SCOTT, TRUSTS § 171.2 (2d ed. 1956); 2 BOGERT, *op. cit supra* note 72, § 555.

74. In reality the courts have asked themselves whether, if the act which the trustee has to perform were to be done by the average man of business with regard to his own property but with the motives similar to the trust motives in mind, that business man would consider the act so important and so within his capacity that he must do it personally, or would treat it as one which he could reasonably leave to a servant, agent or a specialist. If the hypothetical business man, in view of the character of the act and his own qualifications for doing it would take direct personal control of the function, then the courts expect the trustee to do likewise; but if the business man would employ an outside expert or use a regularly employed agent or servant, then the trustee is given similar liberty.

Ibid.

Trusts impliedly recognizes that position.⁷⁵ Thus, the common law does not automatically foreclose the issue of whether lawyers may practice in a business trust.

One solution is simply to conclude that when a legislature authorizes formation of business trusts for a particular purpose, it at the same time sanctions the delegation of any authority reasonably necessary to the functioning of the trust for the permitted purpose. Thus, since business trusts have been authorized in Indiana for the practice of professions, the professions must be permitted such centralized management as will not offend their respective ethical requirements. But because an equally compelling inference is that the legislature left the question of the availability of the business trust as a form for professional practice to the ethics committees of each profession and, in the case of attorneys, to the judiciary as well, it is necessary to consider the impact of the ethical canons upon the central management characteristic.

The common law requirement of centralized management seems incompatible with the traditional concept of the lawyer's self-reliance, integrity and personal responsibility to his clients.⁷⁶ The principle embodied in Canon 31 that lawyers must be free to exercise their own judgment in legal matters, has been an integral part of the canons of ethics since their adoption in 1908 and would perhaps, standing alone, proscribe centralization of management. But in Opinion 303 the ABA Committee stated that Canon 31 was designed to prevent non-lawyers from controlling the work of a lawyer, not to prevent one lawyer directing another. As long as the organization or its managers are all lawyers, centralized management would not violate Canon 31.⁷⁷ It appears that the committee has expressly sanctioned a practice indulged in by nearly all law partnerships throughout the country—some lawyers do direct the efforts of other lawyers. In today's law firm most partnership agreements provide for firm management by either a single partner or a central management commit-

75. See the RESTATEMENT (SECOND), TRUSTS § 171(d) (1959).

76. No lawyer is obliged to act either as adviser or advocate for every person who may wish to become his client. He has the right to decline employment. Every lawyer upon his own responsibility must decide what employment he will accept as counsel, what causes he will bring into Court for plaintiffs, what cases he will contest in court for defendants.

ABA CANONS OF PROFESSIONAL ETHICS, Canon 31 (1908). Only one minor change has been made in this canon since its adoption. The word "employment" was substituted for the word "business" in 1937. For a history of the Canons of Professional Ethics and the way in which they have been changed since their adoption in 1908 see DRINKER, LEGAL ETHICS (1953).

77. ABA Committee on Professional Ethics and Grievances, *supra* note 34, at 161.

tee.⁷⁸ There would seem to be no difference between law partnerships in which some partners have management responsibility, and business trusts where trustees would make such decisions.⁷⁹

But the statement of opinion 303 is troublesome because of its seemingly unqualified position that there is nothing ethically wrong in allowing one lawyer to control the efforts of another lawyer. One can certainly contemplate situations when the directions of a lawyer-trustee would be contrary to the best interests of a client, and at that point the lawyer-employee is faced with a difficult decision which may be resolvable only by his leaving the organization. Such a situation could of course occur in an orthodox partnership as well. Opinion 303 probably means that there is nothing inherently improper in one lawyer controlling the efforts of another lawyer, and when questionable situations arise they will be judged on the facts rather than by an unqualified rule.

It is submitted, however, that the common law requirement of centralized management would not require trustees of a business trust to direct every effort of member-attorneys. One authority has persuasively contended that the type of decisions which the lawyer must make in his everyday handling of cases would merely execute business within the general policy decisions of the central management committee.⁸⁰ The trustees would make those decisions necessary to control the organization, *vis.*, determining what clients to represent in cases with conflicting interests, the types of cases to handle, formulating standards for hiring staff attorneys, fixing salaries, the percentages of members and granting bonuses, administering promotion schemes, supervising the keeping of records and confidential information, insuring the highest standards of conduct and carrying out programs of continuing legal education for lawyer-employees. In terms of the entire scope of the business trust many

78. CARRINGTON & SUTHERLAND, ARTICLES OF PARTNERSHIP FOR LAW FIRMS 87 (1961), a pamphlet prepared for the American Bar Association Standing Committee on Economics of Law Practice. The source material for this pamphlet was gathered from 124 partnership agreements under which law firms were operating throughout the country. The firms from which the agreements were acquired were law firms recognized as outstanding leaders of the bar in their respective states. A special effort was made to obtain agreements from small partnerships in order to gain a representative picture of all types of law firms. Approximately forty per cent of the agreements examined came from law firms having seven or less members.

79. Ohl, *Corporate Practice of Law in New York*, 40 TAXES 263, 285 (1962). "The fact of business life today is that in all large firms the multiplicity of necessary activities requires that they be dealt with by less than all of the group if the firm's end results are to be competitive with today's form of doing business. If legal theory were put into actual practice, to wit, that everyone did a part of everything, the only result would be confusion confounded."

80. Ohl, note 79 *supra*, at 284. The enumeration in the text is partially based upon Ohl's comments.

of these decisions would be necessary for exclusive management authority in the trustees, but would not necessarily include the power to direct the handling of each case in a particular manner.⁸¹ If Professor Bogert has correctly delineated the common law strictures on delegation of discretionary functions, the right of a lawyer to make independent decisions in his everyday work would not violate the trustees' management prerogatives. But whether a professional business trust can satisfy the centralized management concepts of the IRS is another matter.

Under the Internal Revenue Code "centralized management means the concentration of continuing exclusive authority to make independent business decisions on behalf of the organization which do not require ratification by members of such organization."⁸² This exclusive authority must be vested in a managing body of fewer than all the organization's members, who are periodically elected or are a self-perpetuating body.⁸³

The Treasury Regulations do not give examples of the management decisions necessary to constitute exclusive authority, but only admonish that centralized management will not exist when the central authority performs nothing more than ministerial acts.⁸⁴ However, in the unreported Colony Medical Group ruling,⁸⁵ the Director of the Tax Rulings Division considered the degree of control that had to be exercised over a doctor working for an organization to satisfy the requirements of centralized management. The division held that the facts and circumstances had to be considered on a case by case basis and that the emphasis of employer-employee relationship for a professional person shifts from the question of the right to supervise specific details to the degree of control exercised over general policies and standards of performance.⁸⁶ If this ruling manifested the service's present attitude toward satisfying the centralized management characteristic, unquestionably lawyers could meet

81. *Id.* at n.113 and accompanying text.

82. Treas. Reg. § 301.7701-1(c)(2) (1960).

83. Treas. Reg. § 301.7701-2(c)(1) (1960).

84. Treas. Reg. § 301.7701-2(c)(3) (1960).

85. 617 CCH 1961 STAND. FED. TAX REP. ¶ 6375; 625 CCH 1962 STAND. FED. TAX REP. ¶ 4939.23. The private ruling was rendered in the form of a letter dated March 2, 1961 signed by John W. S. Littleton, Director, Tax Rulings Division.

86. Because of the nature of professions the following factors are to be considered in determining whether or not a professional practitioner is subject to centralized management:

(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.

Ibid.

that condition to taxation as an association; it would be satisfied for the same reasons as the common law requirement. But the seemingly receptive attitude of the IRS has proved gravely misleading in light of the proposed amendments to Section 301.7701-2 of the Treasury Regulations.⁸⁷ They prescribe nine decisions over which managers of a professional association must have "continuing exclusive authority" for centralized management:

(i) the hiring and firing of professional members of the organization and its professional and lay employees, (ii) the compensation of the members and of such employees, (iii) the conditions of employment—such as working hours, vacation periods, and sick leave, (iv) the persons who will be accepted as clients or patients, (v) who will handle each individual case or matter, (vi) the professional policies and procedures to be followed in handling each individual case, (vii) the fees to be charged by the organization, (viii) and the nature of the records to be kept, their use, and their disposition, and (ix) the times and amounts of distributions of the earnings of the organization to its members as such.⁸⁸

In its proposed regulations the IRS has referred to the possible conflict of interest which could arise were one lawyer to directly control the efforts of another in his everyday practice, and asserts that even if a professional association could establish some measure of centralized management, the traditional responsibility of a practitioner to his client precludes any professional association from possessing centralized management under the code.⁸⁹ Not only has the IRS prescribed a list of decisions whose apparent purpose is to flatly deny professional associations the characteristic of centralized management, but it has attempted to foreclose any discussion and resolution of the ethical problems by concluding that centralized management cannot be attained in any such association

87. Proposed Treas. Reg. §§ 301.7701-1, -2, 28 Fed. Reg. 243 (1963).

88. Proposed Treas. Reg. § 301.7701-2(h)(3), 28 Fed. Reg. 243 (1963).

89. Moreover, although a measure of central control may exist in a professional service corporation, the managers of a professional service corporation in which a member retains traditional professional responsibility cannot have the continuing exclusive authority to determine all of the matters described in the preceding sentence. Instead, such measure of central control is no more than that existing in an ordinary large professional partnership which has one or more so-called managing partners and in which a member retains the traditional professional autonomy with respect to professional decisions and the traditional responsibility of a professional person to the client or patient. Such measure of central control is essentially different from the centralization of management existing in an ordinary business corporation.

because of professional ethics.⁹⁰ The service claims that any measure of centralized management in a professional association is equivalent to that in the traditional large partnership, and is essentially different from that of an ordinary corporation.⁹¹ This position recognizes neither the broad scope of centralized management which exists in today's law partnerships, nor the fact that partnership management directs litigation without creating ethical crises for its members and associates. Perhaps the IRS should concentrate on objective standards and leave the determination of lawyers' ethical ability to meet them to the ethics committees.

The fate of the proposed regulations is uncertain, but even should they not be adopted the conservative view they mirror must be considered by lawyers assessing the benefits of a professional business trust. There is little doubt that lawyers' management of associates by stipulating the "policies and procedures to be followed in handling each case," and determining the "fees to be charged by the organization," would violate the canons of ethics. The ability of lawyers to ethically satisfy the regulations' centralized management requirement as now conceived by the IRS will therefore depend almost exclusively on an interpretation of the words "continuing exclusive authority" to make such decisions. If the trustees are *required* to make each and every one of the decisions enumerated in the proposals, the requirement of centralized management will violate the ethics of the legal profession. If, on the other hand, the trustees of a business trust organized to practice law are required to make the controlling decisions only when a conflict of interest arises, centralized management will not transgress those ethics.⁹²

90. *Ibid.*

91. *Ibid.*

92. *Ibid.* The precise meaning of the terms "continuing exclusive authority" is subject to question and their interpretation may cast considerable doubt upon the reasonableness with which the list of decisions for centralized management has been devised. If continuing exclusive authority is interpreted to mean that these decisions must be made by no one other than the managers of a professional association, the IRS has imposed requirements upon professional associations which none but the smallest of corporations can meet and which seem to be totally inconsistent with the entire history of associations. For example, it seems naive to even intimate that the board of directors of a medium-sized corporation makes the decision to hire and fire every person employed by the organization or the compensation each employee will receive. It seems even more naive to suppose that the board of directors will determine the persons who will be accepted as clients of the organization, the procedures to be followed in each business deal embarked upon by the corporation, the price to be exacted in each case, and the nature of the records to be kept concerning all transactions. To require this would place an impossible burden upon the board of directors.

If, on the other hand, "continuing exclusive authority" is interpreted to mean that the power to make these decisions must rest with the managers, but that their exercise of that power is largely in reviewing actions of delegates and that in the case of conflict, the decision of the managers is controlling, the decisions listed in the proposed regulations are not unreasonable.

Free Transferability of Interests

In general, for an organization to have free transferability of interests under the Internal Revenue Code, each one of its members must "have the power, without the consent of other members, to substitute for themselves in the same organization, a person who is not a member of the organization. . . . [T]he members must be able without the consent of other members to confer all the attributes of his interest in the organization."⁹³ The regulations recognize that a modified form of free transferability, though it will be accorded less weight than unrestricted transferability, will suffice.⁹⁴ Such a modified form would exist, *e.g.*, if a member could transfer his interest in the association only after having offered it to other members at its fair market value.⁹⁵ The attributes of membership in an association which are generally transferred are the right to share in the profits, to vote in the election of management and, in business trust arrangements, the ability to become a trustee. The unique transferable interest held by members of a professional business trust would be the right to be employed.⁹⁶

The Indiana Business Trust Act (local law) presents no obstacle to the free transferability of trust interests; it expressly allows either restricted or unrestricted transferability.⁹⁷ Without question, the characteristic of unmodified free transferability of interests would violate several of the lawyer's ethical precepts. Canon 33 prohibits partnerships of lawyers and non-lawyers, and certainly this prohibition would apply to business trusts. Substitution of a non-lawyer as a shareholder of a business trust would necessarily violate that canon, and because the substitution would entitle the non-lawyer to a share of the trust's proceeds obtained from legal fees, Canon 34 would be violated as well. Furthermore, a non-lawyer who exercised the voting right of a member could indirectly control the efforts of lawyers employed by the trust, thus violating Canons

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

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

95. *Ibid.*

96. Under the proposed regulations an additional attribute of a member's interest is the right to employment by the organization:

The right of a member of a professional service organization to share in its profits is generally dependent upon the existence of an employment relationship between him and the organization. In such case, free transferability of interests within the meaning of paragraph (e) of this section exists only if the member, without the consent of other members, may transfer both the right to share in the profits of the organization and the right to an employment relationship with the organization.

Proposed Treas. Reg. § 301.7701-2(h) (5) (i), 28 Fed. Reg. 243 (1963).

97. IND. ANN. STAT. § 25-4802(a) (Burns Supp. 1963).

31 and 35.⁹⁸ Also, the non-lawyer might have access to confidential client files while not restrained by the ethical standards of the bar as to nondisclosure of personal information, a violation of Canon 37.⁹⁹ Finally, if a non-lawyer could acquire interests in a trust, what formerly was a professional organization would be transformed into a mere lay agency. For a lawyer to practice in such an organization holding itself out as a professional business trust would be to aid the unauthorized practice of law, and would violate Canon 47.¹⁰⁰

To satisfy the ethics of the legal profession therefore, the professional business trust must not allow a member's beneficial interest to permanently fall into the hands of a layman.¹⁰¹ All the relevant canons

98. "Every lawyer upon his own responsibility must decide what employment he will accept as counsel, what causes he will bring into court for plaintiffs, what cases he will contest in court for defendants." ABA CANONS OF PROFESSIONAL ETHICS, Canon 31 (1908). Similarly, ABA CANONS OF PROFESSIONAL ETHICS, Canon 35 (1928) provides that "the professional services of a lawyer should not be controlled or exploited by any lay agency, personal or corporate which intervenes between the client and lawyer. . . . He should avoid all relations which direct the performance of his duties by or in the interest of such intermediary." A lawyer who was a member of an organization which also had non-lawyer members would place himself in a position to accept directions from non-lawyers as to the course of conduct he should pursue for his client, thus violating both of these canons.

99. ABA CANONS OF PROFESSIONAL ETHICS, Canon 37 (1928) provides in part: It is the duty of a lawyer to preserve his clients' confidences. This duty outlasts the lawyer's employment, and extends as well to his employees; and neither of them should accept employment which involves or may involve the disclosures or use of these confidences, either for the private advantage of the lawyer or his employees or to the disadvantage of the client, without his knowledge and consent, and even though there are other available sources of such information.

100. "No lawyer shall permit his professional services, or his name to be used in aid of, or to make possible, the unauthorized practice of law by any lay agency, personal or corporate." ABA CANONS OF PROFESSIONAL ETHICS, Canon 47 (1937).

101. ABA Committee on Professional Ethics and Grievances, *Opinion* 303, 48 A.B.A.J. 159 (1961). There are times, of course, when a lawyer's interest cannot avoid passing into the hands of non-lawyers:

When lawyers die their property interests must pass to someone. The enforcement of creditor's claims against lawyers leads to the transfer of their property interests. Incompetence of lawyers calls for the administration of their holdings by a conservator or guardian. In each of these instances, and in others of a related kind, a non-lawyer may take over the control of the lawyer's property interest. If the professional association or professional corporation recognizes the transferability of a lawyer-member's interest to persons other than lawyers only for a limited purpose of the administration of the lawyer's property holdings on death, incompetence, bankruptcy, etc., and requires that in a limited period of time his interests must be transferred to a lawyer or lawyers, no violation of the Canons of Ethics is present because of the presence of this limited transferability, provided, non-lawyers who acquire an interest under these limited circumstances are not entitled to access to the confidences of any client and have no voice in the management of the association or corporation and cannot participate in any distributions based on fees earned during such limited period.

Ibid.

and the Treasury Department's requirement of free transferability of interests could be met by a system of modified transferability similar to that often found in close corporations with options to purchase first in the trust, second in the beneficiaries pro rata, third as the beneficiaries can and will purchase, fourth, opportunity to sell to outside lawyers and finally a requirement that the trust and beneficiaries purchase the otherwise unsold shares at a reasonable price.¹⁰²

Even if the trust restricted the transfer of members' shares to lawyers, troublesome ethical problems are raised by Canon 34 which prohibits the division of fees among lawyers on any basis except as compensation for responsibility assumed or services rendered. While practicing lawyers can clearly divide fees, it is unclear what constitutes the assumption of responsibility for the purpose of sharing in fees. The ABA Committee has classified this question one of law, and thus has refused advisory opinions on the matter;¹⁰³ but it has indicated that supervision and control will be important factors in finding the responsibility which would permit sharing in fees.¹⁰⁴ It is probable that sharing fees on the basis of

102. ABA COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES, *Opinion 266*, in CANONS OF PROFESSIONAL AND JUDICIAL ETHICS, OPINIONS OF COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES 552 (1957).

In accomplishing the resale of shares of a lawyer-member, the value of the share may not include compensation for his proportionate part of the good will of the firm. "The good will of the practice of a lawyer is not . . . of itself an asset either he or his estate can sell." *Ibid.* Therefore, to avoid a violation of legal ethics and at the same time compensate a lawyer for his real worth to the business trust, an organization could provide for a periodic adjustment in the number of shares owned by members, reflecting both the capital assets of the firm and the responsibility assumed by each member.

103. ABA COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES, *Opinion 63*, in CANONS OF PROFESSIONAL AND JUDICIAL ETHICS, OPINIONS OF COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES 159 (1957): "The committee does not express opinions concerning questions of law. . . . Ordinarily no ethical problem is involved in such a controversy." Relying upon the basis of this opinion the committee later held that "it is not the province of this committee to measure the services rendered or responsibility assumed or incurred by the respective lawyers." Committee on Professional Ethics and Grievances, *supra* note 101.

The committee did speak to the question of responsibility in its Opinion 303 and said:

All lawyers within an organization bear a professional responsibility for the legal services of the organization whether they are under any personal liability for all of such services or not. This general professional responsibility of all, though legal liability is limited, prevents any violation of Canon 34, when lawyers in the organization are entitled to share in the fees collected without regard to whether they personally participated in the rendition of legal services.

ABA Committee on Professional Ethics and Grievances, *supra* note 101, at 160. Although this portion of the opinion concludes that being within the organization does constitute sufficient responsibility for a division of fees, it avoids the crucial issue of what acts are sufficient to bring a lawyer "within the organization."

104. The extent of the service rendered, if any, or of the responsibility, if any, incurred or assumed by a lawyer . . . may vary in particular cases, depending in no small degree, upon whether the client was advised that other counsel

mere ownership and the exercise of voting rights would not escape the proscriptions of Canon 34, for the underlying purpose of the canon is to prohibit attorneys from sharing in fees collected by others for which they rendered no legal services.¹⁰⁵ This conclusion would seem justified even though the same ownership by a layman would give him such control as to render the association "nonprofessional." Thus, to share in the fees collected by the business trust, attorneys would have to engage in additional activities, and any conduct which fairly evidenced an employment relationship between the trust and member would probably satisfy Canon 34.¹⁰⁶ Moreover, once responsibility is established in conformity with ABA standards, it may be expected that courts would not insure that salary perfectly reflects the amount of responsibility assumed.¹⁰⁷ That would require the impossible task of policing all agreements. Since each lawyer may withdraw from an organization if he feels that the division of fees does not properly reflect responsibility, courts as a practical matter will have to assume the division proper unless proven excessively

should be retained, whether the retainer or selection was made with or without the client's request or approval, and whether supervision or control was received or maintained as to the acts or conduct of the retained lawyer. . . . The implication of these elements are obvious and may determine the existence and measure, or non-existence, of "responsibility" within the meaning of Canon 34.

ABA COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES, *Opinion* 204 in CANONS OF PROFESSIONAL AND JUDICIAL ETHICS, OPINIONS OF COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES 415 (1957).

105. DRINKER, *LEGAL ETHICS* 186 (1953). If these acts are not sufficient to constitute supervision or control and a violation of ethics results from dividing fees on such a basis, it may be necessary to require all retired lawyers to retransfer their shares to the business trust. The possible violation of ethics seems somewhat more remote in the case of retired lawyers than in the case of a lawyer who does no more than invest money in a business trust. A common practice of law firms is to retain senior retired partners for consultation and to provide them with an office to conduct activities on a part time basis if they so choose. See CARRINGTON & SUTHERLAND, *supra* note 78, at 69. If a retired partner is not retained on such a basis, a procedure could be established for gradual retirement where shares would be retransferred to the trust. Under a gradual retirement program, a lawyer would sell a portion of his shares at one year intervals until he no longer owned shares at the time of retirement. An alternative or supplementary method would be to reduce the salary paid to a retiring lawyer so that, in part, the amount of money received would reflect the service to the law firm.

106. The IRS has arrived at the same conclusion in the proposed amendments to Treas. Reg. § 301.7701-2 (1960). After defining employment relationship "to include any active participation in the conduct of the organization," Proposed Treas. Reg. § 301.7701-2(h) (2), 28 Fed. Reg. 243 (1963), it concludes that "the right of a member of a professional service organization to share in its profits is generally dependent upon the existence of an employment relationship between him and the organization." Proposed Treas. Reg. § 301.7701-2(h) (5) (i), 28 Fed. Reg. 243 (1963).

107. In Indiana a proceeding may be brought in any circuit or superior court to revoke the admission of an attorney to the bar for wilfully violating the duties of an attorney as prescribed by statute, or for wilfully violating his oath. IND. ANN. STAT. § 4-3614 (Burns 1946). Additionally, disbarment proceedings may be initiated as original actions in the supreme court. IND. SUP. CT. R. 3-21.

disproportionate.¹⁰⁸

In addition to satisfying ethics, modified transferability should also meet existing Treasury Regulations. But again the newly proposed regulations becloud the picture. They would deny the characteristic of free transferability of interests to professional association by simply declaring that transferable "interests" within the code do not include the right of employment and the duties inherent in professional trust management, when the trust or beneficiaries have options to purchase the shares being sold.¹⁰⁹ This construction of the code utterly defies logic and rational analysis. When employment is an incident of ownership there seems to be no reason why it should have to be more easily transferred than the right to dividends. The power of the trustees to hire and fire is limited to non-members, except when the trust would buy a member's shares and reissue them to a new member. This power constitutes a small encroachment upon the characteristic of centralized management, but does not prevent a member's employment relationship from being transferred or called in as his ownership might be. It is doubtful that this arbitrary distinction in the proposals will be incorporated within the regulations, but should it be, it is submitted that courts would not feel bound to accept it.

One writer has suggested that free transferability of interests in a professional association is ludicrous in light of all the restrictions which professional ethics would require be imposed upon the transfer of shares.¹¹⁰ This contention more directly approaches the question than the IRS proposals which concentrate on a single factor presumably making transferability of interests impossible. Nevertheless, a restraint on alienation does not exist when an owner can reasonably divest himself of property and obtain a fair price for it. Under a system of options to buy and sell the owner of the trust certificate is assured of transferring it for a fair price within a reasonable time which should qualify the property as sufficiently transferable. There is no reason to view transferability from the standpoint of a prospective buyer.

Continuity of Life

An organization possesses continuity of life when it cannot under lo-

108. ABA Committee on Professional Ethics and Grievances, *supra* note 104.

109. Although a so-called right of first refusal in connection with the transfer of the interest of a shareholder of an ordinary business corporation may not prevent a modified form of transferability of interests within the meaning of paragraph (e) of this section, such right of first refusal applies only to the right to share in the profits and assets of the enterprise.

Proposed Treas. Reg. § 301.7701-2(h)(5)(ii), 28 Fed. Reg. 243 (1963).

110. Bitker, *Professional Associations and Federal Income Taxation: Some Questions and Comments*, 17 TAX L. REV. 1 (1961).

cal law be dissolved through the death, insanity, bankruptcy, retirement or expulsion of any member.¹¹¹ Dissolution is "an alteration of the identity of an organization by reason of a change in the relationship between its members as determined under local law."¹¹² Under the Indiana Business Trust Act the legal existence of the trust is controlled by its creating instrument unless the board of trustees votes to terminate the trust.¹¹³ So long as the trust instrument provides for the continuing existence of the business trust, the power of the trustees to dissolve the organization would not prevent satisfying the present regulations' requirement of continuity of life.

But the proposed Treasury Regulations would not allow the same conclusion. The IRS now takes the position that for an organization to have continuity of life, it must not be subject to dissolution upon the withdrawal of a member-beneficiary because of (1) operation of the law, (2) applicable regulation or (3) professional ethics.¹¹⁴ Unlike partnerships, a professional business trust would not by a member's withdrawal dissolve by operation of law.¹¹⁵ However, without providing in the trust instrument or by subsequent agreement for a system of options to buy and sell shares of withdrawing members, shares might fall into the hands of non-lawyers and require dissolution by lawyer-members to avoid ethical conflicts. Thus, the lawyer's business trust continues its life by agreement, and not by operation of law. The IRS would equate for tax purposes such an organization which continues in law by its agreement to continue in fact, to the partnership which the law may dissolve and its agreement continue.

The different aspects of continuity which the two agreements provide, however, are obvious. While mere de facto continuity, tested only at infrequent intervals of membership withdrawal, would be a tenuous and insufficient basis of continuity to warrant characterization as a separate entity for taxation purposes, the professional business trust with its armor of options and guarantees for buying and selling members' in-

111. Treas. Reg. § 301.7701-2(b) (1960).

112. *Ibid.*

113. IND. ANN. STAT. § 25-4811 (Burns Supp. 1963).

114. Proposed Treas. Reg. § 301.7701-2(h)(2), 28 Fed. Reg. 243 (1963).

115. It may be stated as a general rule that unless the trust instrument so provides, the death of one or more shareholders of a business trust does not have the effect of dissolving or terminating the organization. The perpetuity of the organization notwithstanding the death of members or the transfer of interests, is one of the fundamental characteristics of such trusts and one of their chief advantages.

Annot., 156 A.L.R. 22, 209 (1945).

terests is suited from its inception to continue life interminably.¹¹⁶ While an agreement governing the relationships between members is necessary to continuity, the business trust is not only like the corporation in its desire and ability to continue as a legal entity, but the experiences of large law partnerships prove that a continued existence in fact would result. The professional business trust therefore could possess a modified form of continuity of life, and whether the IRS is justified in its position to deny that fact any significance for tax purposes is questionable. The resolution of this issue must await a determination of the proposed regulations' fate.

As to the ethics of continuity of life in a professional association, because that characteristic necessarily involves transferability of interests, the majority of the ethical problems which it could raise have been discussed. The one independent ethical problem posed by continuity of life arises over use of a firm name for a lawyer's business trust. Canon 33 prohibits a judge's name in a firm title, and in certain cases the name of a deceased. As shares are transferred during the life of a trust it may become necessary to change its name to avoid unethical practice. But such changes would not affect the identity of the organization under Indiana law; its legal existence would be unaltered.¹¹⁷

III. MISCELLANEOUS ETHICAL CONSIDERATIONS

Profit Sharing Plans and Death Benefits

Among all of the tax benefits achieved from classification as an association only profit sharing, retirement and death benefit plans seem to raise ethical questions for attorneys. The Internal Revenue Code specifies that profit sharing and pension plans, to receive favorable tax treatment, must not be created and administered so as to discriminate in favor of management employees.¹¹⁸ Because the code would therefore require the plans of a professional business trust to encompass both its profes-

116. It is conceivable that the remaining members of a business trust might, when a particular transfer is to be made, refuse both to exercise the right of first refusal and to employ the successor in interest causing the dissolution of the trust. In such a situation it can be said that the continued existence of the trust is dependent upon the willingness of the remaining members to accept one of the two alternatives as is asserted in the proposed regulations. It is questionable whether the IRS in its proposed regulations attached any significance to this fact. Nonetheless, it should be noted the possibility of dissolution in this manner is extremely remote, and to assert that it prevents a professional business trust from achieving continuity of life would be to give it undue emphasis.

117. *Miles Lamp Chimney Co. v. Erie Fire Ins. Co.*, 164 Ind. 181, 73 N.E. 107 (1904); *Philapy v. Aukuma-Bright Lumber Co.*, 56 Ind. App. 266, 105 N.E. 161 (1914); *State Exch. Bank v. Paul*, 58 Ind. App. 487, 108 N.E. 532 (1915).

118. INT. REV. CODE OF 1954, §§ 401(a)3(A), (B), and 401(a) (4).

sional and non-professional employees, the question arises whether payment under the plans would constitute a "salary" paid out of net profits, and thereby violate Canon 34 as interpreted in the ABA Committee's Opinion 303.¹¹⁹

There is no doubt that a conventional non-retirement profit sharing plan covering non-lawyer employees would violate Canon 34 as an unethical division of fees from legal services. This result, however, would hardly seem justified for retirement plans. Indeed, if profit sharing retirement plans are unethical, the lawyer will be surprised to learn that he cannot utilize either the professional association or the Self-Employed Individuals Tax Retirement Act.¹²⁰ Canon 34 was designed to prevent laymen from soliciting business for a share of the fees from legal services gained through their efforts.¹²¹ Since the benefits of retirement profit sharing plans are delayed for many years, it is hard to envision the secretarial help of a lawyer's business trust influencing friends to engage the trust to increase retirement income. Two writers have asserted that if the committee in Opinion 303 intended to declare profit sharing retirement plans ethically objectionable, they are "just plain wrong on the point."¹²²

119. An organization practicing law may employ many non-lawyers. The source of funds to pay them for their services will be fees for legal services rendered. The use of the fees to pay agreed salaries to non-lawyer employees of course is not a violation of Canon 34. However, if the salary of a non-lawyer employee is to be based on a percentage of the net profits, a division of fees for legal services would be involved and Canon 34 would prohibit it. Thus if a professional association or professional corporation is organized to practice law and it is approved as a corporation for federal tax purposes, it would not be ethically proper for it to have a profit sharing plan if non-lawyers were included as beneficiaries of the plan.

ABA Committee on Professional Ethics and Grievances, *supra* note 101, at 161.

120. ABA Section of Taxation, *Report of the Special Committee to Cooperate with ABA Committee on Professional Ethics Re Associations of Attorneys Taxable as Corporations*, ABA Taxation Bull., Oct. 1961, p. 41, at 53.

121. Fruetal & Frost, *Why Lawyers Should Have the Right to Practice in Corporate Form*, 37 CALIF. S.B.J. 874, 887 (1962). "The underlying purpose of Canon 34 is to avoid the temptation to solicit business by a layman who expects to share in the legal fees resulting from such solicitation."

122. It has also been said that splitting fees with a layman opens the door to the unlawful practice of law by laymen or disbarred attorneys. It seems ridiculous to suggest that a bookkeeper or legal secretary would be motivated to solicit business for her employer or to practice law because his contribution to a profit-sharing retirement plan in which she participates is based upon a percentage of profits rather than a fixed amount per year. Moreover, the contributions pursuant to a profit-sharing retirement plan, although contingent upon profits, are merely a method of funding the plan, the proceeds of which are distributable only upon retirement, death or earlier termination of service. Assuming a law partnership has a history of earning a certain level of profits and then adopts a profit-sharing retirement plan, the contributions to which are well within its historic level of profits, it would seem that the inclusion of lay personnel in such a profit-sharing retirement plan would no more be a violation of Canon 34 than would be the payment of fixed salary or fixed

But until the committee clarifies its position as to the meaning of "salary," lawyers may be reluctant to create profit sharing retirement plans for tax advantages.

The ethical propriety of a death benefit paid to the estate or beneficiary of a deceased trust member may also be questioned as a sharing of fees with non-lawyers. Opinion 308 of the ABA Committee approved the payment of a death benefit to a deceased lawyer's estate from partnership assets.¹²³ The committee ruled that as long as the amount and method of payment were determined prior to death, and it constituted either delayed compensation or an approximation of the decedent's interest at time of death, the payment would not violate professional ethics.¹²⁴ Such payments by a lawyer's business trust could be expected to receive similar approval.

General Objections

From all the foregoing discussions it is reasonably certain that an association which observes the proper safeguards in establishing corporate characteristics and is seeking tax benefits, can practice law in a business trust without violating the Canons of Legal Ethics. At the same time many of the objections which have been posed against the corporate practice of law are not based on any specific canon, but rather on general policy. An attempt will be made to evaluate at least a major portion of these arguments.

The Indiana Supreme Court has joined with most other state courts in ruling that the practice of law is restricted to natural persons as a protection to the public, upon the apparent presumption that a corporation is not deserving of the same personal trust as a person.¹²⁵ But this argu-

bonus payments out of an expected level of fees.

Ibid.

123. ABA Committee on Professional Ethics and Grievances, *Opinion* 308, 49 A.B.A.J. 893 (1963). The question submitted to the committee was raised by a recommended provision of a partnership agreement in CARRINGTON & SUTHERLAND, *supra* note 78, at 55. The provision entitled the estate of the deceased or his survivors to a series of forty-two consecutive monthly installments, beginning on or before one hundred twenty days after the date of his death, a further amount which (except as otherwise herein provided) shall be the average of the sums paid to him as a partner of the firm during each of the last three complete fiscal years of the firm during which he was a partner.

Ibid.

124. ABA Committee on Professional Ethics and Grievances, *Opinion* 308, 49 A.B.A.J. 893 (1963).

125. "The practice of law is restricted to natural persons who have been licensed upon the basis of established character and competence as a protection to the public against lack of knowledge, skill, integrity and fidelity." *Groninger v. Fletcher Trust Co.*, 220 Ind. 202, 207, 41 N.E.2d 140, 141 (1942).

ment is result-reaching and its proponents refuse to examine the nature of professional corporations and associations. As long as all an association's members are lawyers the entire organization is indirectly, if not directly, subject to the control of the courts. Simply because a lawyer is employed by a non-lawyer he is not excused from observing his code of professional ethics, nor has he in doing so automatically violated those ethics. In an organization entirely composed of lawyers, it is difficult to see how the control of the courts over lawyers and their conduct would in any manner be altered.

A second objection urged by some is that the public will regard with disfavor an attempt by lawyers to take advantage of a tax "loophole."¹²⁶ This charge is valid only if lawyers were to obtain *more* than tax equality, which unquestionably they do not seek.

Finally, it is argued that to permit the corporate practice of law would force individual practitioners to establish organizations, being unable to ignore the benefits available.¹²⁷ Thus, it is contended, not only would the individual practitioner be eliminated, a man who furnishes a needed independence and vigor to the legal profession and maintains an unequalled personal relationship with clients, but law firms would tend to become larger.¹²⁸ But those who have advocated the creation of organizations for tax advantages have always been quick to point out that the professional association is not a panacea.¹²⁹ Unless a certain level of income is attained a professional association can prove unwise, especially if it would be taxed as a corporation;¹³⁰ if that level is not met the Self-Employed Individuals Tax Retirement Act would prove much more satisfactory. Moreover, although the single practitioner has been able to make

126. The rash of new statutes is barefacedly and singlemindedly directed toward the attainment of federal income tax benefits. . . . The spectacle of lawyers embracing such a scheme with enthusiasm is unlikely to improve upon the public image of the profession, especially since those operating under the new forms obtain . . . the gratuitous benefit of curtailing their traditional stringent liability toward clients.

Note, 75 HARV. L. REV. 776, 789, (1962).

127. Marcus, *Why Lawyers Should Not Be Permitted to Practice Law in Corporate Form*, 37 CALIF. S.B.J. 898, 903 (1962).

128. *Ibid.*

129. Ohl, *supra* note 79.

130. To evaluate whether the benefits to be derived are greater than the increased cost of the pension and profit sharing plans, he must have a competent evaluation of his individual situation. The tax bracket in which a man finds himself and the extent of his nonprofessional payroll are factors to be considered. As a general rule of thumb, if he is taxed on his present earnings in a bracket of thirty per cent or higher, he will benefit in savings under this plan.

Buchmann & Bearden, *The Professional Service Corporation—A Business Entity*, 16 U. MIAMI L. REV. 1, 18 (1961).

a valuable contribution to the independence of the legal profession, large law firms do provide an unparalleled quality of service, especially in the more complex areas of the law.¹³¹ In short, to best protect the interests of clients and himself, the lawyer must evaluate the ethics of association on a rational basis, rather than on tradition and subject to arguments which have at times been termed "legal hocus pocus."¹³²

IV. CONCLUSION

The only competent body which may rule on the ethical propriety of practicing law in an association which embodies corporate characteristics is the Supreme Court of Indiana. Since the rules of the Supreme Court do not contemplate the practice of law by a business trust,¹³³ until those rules of procedure are altered to indicate that the court has considered favorably the ethical propriety of practicing law in that form, such practice is impossible. The conservative attitude exemplified by the Ohio Supreme Court could be expected from Indiana's highest court should some persons practice law in a business trust without first obtaining a change in the supreme court's rules of procedure:

The inherent power of this court to prescribe standards for admission to the practice of law has been implemented by the adoption of Rule XIV of its Rules of Practice. By no stretch of the imagination can the words of Rule XIV be expanded to include any other than natural persons. And until such time as this court through its rules for the admission to the practice of law recognizes the right of a corporate entity to practice law, the Secretary of State is under no clear duty to accept for filing and record articles of incorporation which set forth that a purpose of the corporate entity is to "practice law."¹³⁴

131. There is also ground for believing that large firms have brought about higher standards of professional ethics.

In an article in the Law Journal, London, reprinted in 90 N.Y. Law Jour. 426 (Dec., 1933) entitled *The Single Practitioner and Professional Misconduct*, the author says, "It is a striking fact that in over 97% of the cases which have come before the Discipline Committee (London) since 1919 the solicitor whose conduct was complained of had no partner, and that in that period of fourteen years only five solicitors who were in partnership have been struck off the rolls."

DRINKER, *LEGAL ETHICS* 203, 204 (1953).

132. Lewis, *Corporate Capacity to Practice Law—A Study in Legal Hocus Pocus*, 2 MD. L. REV. 342 (1937).

133. See IND. SUP. CT. R. 3-1 to 26.

134. State *ex rel.* Green v. Brown, 173 Ohio St. 114, 180 N.E.2d 157 (1962). Rule XIV of the Ohio Rules of Civil Procedure governing admission to the practice of law is quite similar to the rules for admission to the practice of law in Indiana, and the same implicit restrictions are present in both.

If attorneys conclude after thoughtfully considering the present and proposed Treasury Regulations that they can ethically practice in business trust form and achieve the tax benefits of corporate organization, the State Bar Association should be urged to petition the supreme court for a rule change. The bar association of one state has taken this approach, thus recognizing that the matter falls within the constitutional authority of a state's highest court.¹³⁵ This course of action resulted in that instance in a critical analysis and ultimate approval of the proposal.

A great responsibility has been placed upon Indiana's judiciary and legal profession to critically evaluate in light of the Canons of Professional Ethics the business trust as an organization for the practice of law. They must weigh the advantages to be gained, with the possible disadvantages which might result. If they conclude that professional ethics do not proscribe practice in business trust form, and the supreme court condones such practice through their rules of procedure, adequate safeguards should be provided in those rules to insure the public welfare would not thereby be adversely affected.