
Haldane Robert Mayer
cases, the scope of the "clear conflict" test is a question which will be presented in the future.

MICHAEL E. KRIS


During the first ten months of 1965, Empey was a lawyer-employee of a professional service organization.¹ On November 1 of that year he became a ten percent shareholder. In his federal income tax return for 1965 he reported the salary he received for the first ten months, and in addition reported ten percent of the net income of the organization for November and December although he actually received no part of such income. This was done in the apparent belief that the organization was taxable as a partnership. Later, contending that the organization should be taxed as a corporation rather than as a partnership, Empey filed a timely claim for refund of the tax paid by him on the difference between his salary and his share of the corporate net earnings for November and December. Through inaction, the Internal Revenue Service rejected the claim, thereby tacitly ruling that under Treasury regulations the professional service corporation was a partnership for purposes of taxation.² Empey brought suit in the federal district court³ to


². Professional service corporations and associations, organized under local statutes, vary in their characteristics from state to state. Normally, this type of organization falls somewhere between a corporation and a partnership depending upon the possession or non-possession of corporate attributes.

One such attribute, that of continuity of existence, is found in most professional corporations but is restricted by the requirement that shareholders be members of the profession practiced by the organization, e.g. medicine or law. Many states require that the stockholder also be an employee. Dissolution and reformation of the enterprise are not necessary after the death or departure of a shareholder, however, as is often the case with a partnership.

Centralization of management is a characteristic found in varying degrees among partnerships as well as corporations and professional associations. Of course, the man-

². Empey v. United States, — F. 2d — (10th Cir. 1969)
compel the Commissioner to recognize the corporate character of the organization and to tax it accordingly.

The court held that, according to its interpretation of the pertinent parts of the Internal Revenue Code of 1954 and subsequent Treasury regulations, this professional service corporation should have been taxed as a corporation, not as a partnership. The regulations were held to conflict with the statutory definition of a corporation and were, in effect, an attempt by an executive body to perform nondelegable legislative functions and as such were invalid and unenforceable. The United States Court of Appeals for the Tenth Circuit affirmed the lower court decision.

Since 1935, the Commissioner has consistently and successfully advocated the “resemblance doctrine” to place an enterprise in the category of a corporation. As long as an organization's characteristics

agreement is subject to the necessary standards of the profession and to ethical considerations

Limited liability is often a distinguishing hallmark of a business corporation, but, depending upon state law, the professional corporation often may not achieve this attribute and hence may more closely resemble a partnership in this respect. Liability insurance has provided an alternative answer to this problem in some states. See, e.g., Colo. R. Civ. P. 265 (1) (G).

Closely allied with the attribute of continuity of existence is that of free transferability of interest. As stated, there are restrictions placed upon transference of interest and often the right of first refusal in the corporation is a condition precedent to allowing an outsider to “buy in,” but these restrictions are merely a variation in the degree of transferability.

See generally Eaton, Professional Corporations and Associations in Perspective, 23 Tax L. Rev. 1 (1967)

By insisting upon an overly strict application of the foregoing characteristics to professional service corporations, the Commissioner relied upon the authority of Treasury regulations in attempting to categorize the corporation as a partnership for tax purposes. These regulations are discussed in notes 15 and 16, infra.


5. infra nn.15, 16.


8. The first case to invoke the doctrine was Morrissey v. Commissioner, 296 U.S. 344 (1935), where the Court held that an enterprise organized as a trust had sufficient characteristics to be classified as an association and hence as a corporation for purposes of taxation under the congressional “definition” of corporation. The definition was substantially the same as that in the Internal Revenue Code of 1954. See Int. Rev. Code of 1954, § 7701(a)(3). This leading decision established the rule that if an organization resembles a corporation it will be taxed as one. The emphasis was on
more resemble those of a corporation than not, it is to be taxed as one.9 Congress definition of "corporation" and "partnership"10 and the broad regulation-making authority given to the Treasury Department11 has enabled the Commissioner repeatedly to sweep "borderline" cases12 into the corporate category. As members of the professions became aware of this trend and of tax advantages accruing to the corporate form13 many organized as corporations.

In 1954, the first attempt to exclude professional service corporations and associations from corporate taxability failed in United States v. Kintner.14 This inability to reverse the long-established pattern of calling a "borderline" case a corporation was the catalyst leading to the promulgation of new regulations in 1960.15 The obvious aim was to

9. Such corporate attributes as continuity of existence, centralized management, limited liability, free transferability of interests, and continuity of property ownership were commonly examined. These attributes were not "weighted" according to relative importance and courts appeared more concerned with theoretical or structural resemblance than with substantive resemblance. Eaton, supra note 2, at 4.


13. By being taxed as corporate entities, lawyers, doctors, and other professional men were able, for the first time, to take advantage of tax concessions in establishing qualified pension fund and profit-sharing plans. A step toward achieving benefits long enjoyed by business corporations was thus permitted.

14. 216 F.2d 418 (9th Cir. 1954); accord, Galt v. United States, 175 F. Supp. 360 (N.D. Tex. 1959).

15. Treas. Reg. § 301.7701-1 to -11 (1960). These regulations were called the "Kintner Regulations" because of their obvious purpose. It became more difficult for an organization to be in the corporate category because the new regulations placed greater emphasis upon state law and required that an organization have a majority of the corporate characteristics normally associated with a regular corporation. Reference to state law was contrary to the Commissioner's past position that local law is of no importance. See, e.g., Pelton v. Commissioner, 82 F.2d 473 (7th Cir. 1936); accord, Treas. Reg. § 86, art. 801-1 (1935).
indirectly overrule Kintner. The 1965 amendment to these regulations\(^{16}\) led to the present conflict.

*Empey v. United States* is the first case to be decided under the new regulations (and the first involving a firm of lawyers). By holding the 1965 revision invalid and unenforceable, the court, in effect, decided the case on the basis of the professional service corporation's resemblance to "true" corporations. Other courts have already followed *Empey* in passing upon the efficacy of the regulations as amended,\(^{17}\) and it would appear that the "rule of resemblance" has been implicitly reaffirmed.

HALDANE ROBERT MAYER


Plaintiffs purchased homes in a residential development tract from the Conejo Valley Development Co.\(^{1}\) Due to improper building techniques,

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16. Treas. Reg. § 301.7701-1 to -2 (1965); 1965-1 Cum. Bull. 553. Although the 1960 Kintner Regulations were designed to, and did, make it more difficult for associations to qualify as corporations, Foreman v. United States, 232 F. Supp. 134 (S.D. Fla. 1964), demonstrated that it was still possible to do so. The Commissioner did not seek review of this decision but immediately promulgated the revision which had been under consideration since 1963. Proposed Treas. Reg. § 301.7701-1 to -2, 28 Fed. Reg. 13750 (1963). Whereas the Kintner Regulations, Treas. Reg. § 301.7701-1(c) (1960), emphasized the importance of local law to establish the relationship among the members of an organization and between the organization and the public, the amendment denigrated this standard by providing that "the labels applied by local law to organizations . . . are in and of themselves of no importance in the classification of such organizations for the purposes of taxation under the Internal Revenue Code." Treas. Reg. § 301.7701-1(c) (1965). The revised regulation further stated that an organization, *incorporated* under the laws of a state, would not be considered a corporation unless it met other stated criteria. See *supra* note 9. This was a blatant attempt to circumvent the congressional definition of corporation as including associations and of partnership as excluding incorporated entities.

Treas. Reg. § 301.7701-2(h) (1965), a new provision, attempted to define professional service corporations and associations out of existence as far as federal taxation was concerned. Directed solely toward this type organization, it purported to describe how to apply the Kintner Regulations, but its effect was to clearly demonstrate that for all practical purposes a professional service corporation could not qualify for a corporate tax classification.


1. 69 Cal. 2d 887, 447 P.2d 609, 73 Cal. Rptr. 369 (1968).