that the same test of measurement of the risk of fabrication is at the core of this exception as well. The trial judge will have neither excitement nor absolute contemporaneity to minimize the danger of unreliability, and thus the balance may often tip toward exclusion. In a statement such as Dick's the judge should consider Dick's youth, the nature of the occurrence, and the time elapsed since the event. If under all the circumstances, the trial judge can still determine that the risk of fabrication is very small and the out-of-court declaration is validly unavailable, then the statement should be admitted.

The rules of evidence in Louisiana in the area of excited utterances and present sense impressions are largely judge-made, developed within the structure of applicable statutes. There would seem to be no reason why that development cannot continue its progress toward clarity and consistency by careful analysis of the recognized exceptions for excited utterances and present sense impressions.

H. Alston Johnson III*

LOUISIANA'S PROFESSIONAL CORPORATION ACTS

Professional corporations are of coming importance in Louisiana due to the passage of the Louisiana Legal and Medical Corporation Acts1 and to the significant tax advantages which gave impetus to their passage. Certain tax advantages accrue to professionals practicing as employees rather than as owners. These relate to (1) social security,2 (2) tax deferring pension subject to cross-examination; and the court has placed great emphasis recently upon the importance of cross-examination. Though the Court recognizes that dying declarations and testimony of deceased witnesses who had testified at a former trial have been admitted against an accused, Pointer v. Texas, 380 U.S. 400, 407 (1965), its emphasis on the importance of cross-examination in court should sound a warning signal to those who seek extension of hearsay exceptions.

* The writer wishes to express appreciation to Mr. James D. Davis of the Alexandria bar for the use of a helpful seminar paper in the field of excited utterances and a present sense impression written while a student at LSU Law School.

2. INT. REV. CODE of 1954, §§ 3101-3121. There is no difference between Social Security benefits and those payable under Self-Employment provisions. However, the rates of contribution are lower under Social Security. Compare id. §§ 3101 and 3111 with §§ 1401 and 1402(b) (1) (C).
3. INT. REV. CODE of 1954, §§ 401-407. Under amendment to the above sections it is possible for partnerships to get this tax advantage to a limited degree. This is commonly called a "H.R. 10 plan." The amendment makes a distinction between an owner-employee (one who owns more than 10% of the business) and
plans, (3) group term life insurance and medical benefits, (4) $5,000.00 in tax free death benefits payable to the deceased member's estate, (5) funneling earnings into investments for later distribution, and, finally, (6) electing to be taxed as a partnership if there are less than ten shareholders in the corporation. The attractiveness of these tax advantages has caught the attention of the Commissioner, and for this reason the status of professional corporations is presently in doubt. The cases that have arisen have been unanimous in their approval of the professional corporation, but further litigation will be needed to add a degree of stability to the law in this area. The purpose of this Comment is to explore the professional corporation, its present status and future vitality.

self-employed (one who owns 10% or less of the business). Id. §§ 401(c)(3) and 401(c)(1). Contributions cannot exceed 10% of earned income or $2,500.00, whichever is less for an owner-employee. There is no limit on the amount that can be contributed for a self-employed person, but there is a $2,500.00 limit on deductibility. Id. §§ 401(d)(5)(A) and 404(c). The pension plan may use a trust, annuity, mutual fund, United States Bonds or face-amount certificates. Id. §§ 401(d), (f), and (g). An owner-employee cannot start collecting benefits until after age 59½ unless he is injured or dies. Id. § 401(d)(4)B. The owner-employee must begin collecting before age 70½. Id. § 401(a)(9). Premature distributions are penalized. Id. § 72(m)(5). In the case of a self-employed person the plan must call for payment no later than age 70½ or the year of retirement, whichever is later. Id. § 401(a)(9). Benefits are taxed as deferred income and lump sum payments are taxed as ordinary income. Id. § 72(n)(1), (2).

4. Id. § 162. Providing employees with these fringe benefits is considered as an ordinary and necessary business expense deductible under the above section.

5. Id. § 101(b). Note that the $5,000.00 exclusion is not given to a self-employed individual. Id. § 101(b)(3).

6. If the corporation can demonstrate the necessity of withholding dividends, such as for the purpose of buying its office building or a drug store, the corporation can withhold profits which may be distributed at a later date at capital gains rates. Accumulated earnings tax may be imposed if accumulations are beyond the reasonable needs of the corporation. Id. §§ 531, 532.

The Louisiana Legal and Medical Acts state that the professional corporation shall engage in no business other than the practice of law or medicine, but it may hold property for investment or in connection with its legal or medical practice. LA. R.S. 12:804, 904 (Supp. 1969).

7. INT. REV. CODE of 1954, §§ 1371-1377. By becoming a "tax option" corporation, double taxation is avoided while many of the tax advantages are retained. The requirements for making this election are the following: 1. It must have 10 shareholders or less. 2. All shareholders must be individuals or estates. 3. It must have only one class of stock. 4. It must not have a nonresident alien as a shareholder. Election under the Louisiana Professional Corporation Acts should be exercised with caution because although it states that only one class of stock is authorized, transmission of shares to a nonprofessional causes a suspension of the right to vote or participate in earnings. Thus there may be two classes of shares, those which vote and share in profits and those which do not. See Treas. Reg. § 1.1371-1(g) (1965).

HISTORY OF PROFESSIONAL CORPORATIONS

Corporations have always been taxed on their income as separate entities and at different rates from individuals. The Internal Revenue Code defines the term corporation as including associations. Difficulty arises when an association is not incorporated but has the attributes of a corporation. It seems logical to surmise that Congress, by including association in the definition of corporation, envisioned situations where an unincorporated business entity would be taxed as a corporation. The business entities which first incurred the attention of the Commissioner as possibly being included within the term association were the so-called Massachusetts trusts or business trusts. Under the usual trust agreement contemplating business activities producing passive income (such as dividends, royalties, and rents) distributed to the trust beneficiaries, the income is taxed to the beneficiaries and not to the trust. However, in the business trust where there is participation in an active business, additional considerations arise which may remove it from its status as a trust and cause it to be treated as an association taxable as a corporation.

Litigation of this issue resulted in considerable confusion until the United States Supreme Court held in the landmark case of Morrissey v. Commissioner that the term association used in the definition of corporation meant resemblance to the corporate form rather than identity with it. Thus, an entity will be held taxable as a corporation if it is organized in such a way as to contain the attributes of a corporation. The Supreme Court isolated these attributes as centralized management, continuity of life, limited liability, and free transferability of interest. These attributes later became integrated into the income tax regulations defining a corporation for tax purposes.

Several years later the Morrissey decision was employed by a taxpayer seeking corporate tax treatment. In United States v.

10. The object of the Massachusetts Trust or Business Trust was to obtain for the associates most of the advantages of corporations without the restrictions and regulations imposed by law on them. 12 C.J.S. Business Trust § 2 (1938).
12. 296 U.S. 344 (1935). See also, Pelton v. Commissioner of Internal Revenue, 82 F.2d 473 (7th Cir. 1936), holding a medical group to be an association and thus taxable as a corporation.
13. See regulations to Int. Rev. Code of 1939, § 3797-a(2) and (3).
Kintner, a group of doctors, not capable of incorporating under state law, formed a trust with terms sufficient to bring it within the Morrissey decision. By so obtaining corporate tax status, the member doctors were allowed tax deductions for a pension plan and other benefits not otherwise available to partnerships or individuals. The Commissioner's arguments against corporate tax status were met with the Morrissey rule and his own regulations. The Commissioner elected not to appeal to the Supreme Court, but he did issue regulations directed against corporate status of professionals indicating his unwillingness to follow Kintner.

Professional groups were quick to realize the tax benefits available if they could obtain corporate tax status. Fearful that the Commissioner's regulations would effectively put an end to the results achieved in the Kintner case, these professional groups sought state legislation authorizing the incorporation of professional service groups such as doctors, lawyers, and accountants. This legislation was drafted to counter objections by maintaining the ethical standards of professional men. The Louisiana statutes are representative and will be considered in detail below.

The Commissioner, holding firm to his previous position, issued new regulations to counter the activities of the various state legislatures and the infant professional service corporations. The effect of these regulations was to deny corporate tax status to professional corporations because of insufficient corporate characteristics. Here the rationale of the Morrissey case is used in reverse. If an association can be taxed as a corporation because it resembles the corporate form, it follows that a corporation not having corporate characteristics can be taxed as the entity it most closely resembles. The Commissioner does not believe a professional corporation can be considered a corporation for tax purposes because of the unique personal relationship which arises between the professional and his client or patient.

**LOUISIANA'S PROFESSIONAL CORPORATION AND THE KINTNER REGULATIONS**

The Louisiana Legal and Medical Corporations Acts are identical in substance; thus for the purpose of this article legal

14. 216 F.2d 418 (9th Cir. 1954).
15. Treas. Reg. § 301.7701-2 (a) (1), (2), and (3) (1960).
17. Professional Law Corporations Act, La. R.S. 12:801-815 (Supp. 1969);
and medical corporations will be considered collectively and termed “professional corporations.” This term as used here applies only to legal and medical corporations and should not be confused with the term used in its broadest meaning as including any professional service. Some state statutes are drawn broadly to include all professional services without designating any particular profession.\footnote{Professional Medical Corporations Act, LA. R.S. 12:901-915 (Supp. 1969).}

Both Louisiana acts state

“One or more natural persons, of full age and duly licensed to practice law [medicine] in this state, may form a corporation under Chapter 1 of this Title for the purpose of practicing law [medicine]. Such corporation shall be subject to all of the provisions of Chapter 1, . . . except to the extent that such provisions are inconsistent with the provisions of this Chapter.”\footnote{E.g. see Florida’s Professional Service Corporation Act, FLA. STAT. ANN. ch. 621 (1961).}

The official Comment states that the legislative intention is that professional corporations be the same as ordinary business corporations subject only to the special rules necessitated by the peculiar relationship between lawyer and client or doctor and patient. Thus, professional corporations should have the characteristics of ordinary corporations including continuity of life, centralized management, limited liability, and free transferability of interest.\footnote{LA. R.S. 12:802, 902 (Supp. 1969).} Therefore, in order to fully examine the Louisiana professional corporation, the Morrissey attributes of corporate-ness will serve as a guide.

\textit{Continuity of Life}

The first question is whether the Louisiana acts provide the professional corporation with \textit{continuity of life}. Continuity of life, as that term is generally understood, means that the entity will continue to exist regardless of its owners’ existence. This factor clearly distinguishes a partnership from a corporation.

The Louisiana acts specially provide that an additional ground for involuntary dissolution of a professional corporation will be the absence of voting shareholders.\footnote{See Comment to LA. R.S. 12:802, 902 (Supp. 1969).} Furthermore, under a special provision, a shareholder is not entitled to vote his share or participate in earnings when the shareholder is a person not
licensed to practice law or medicine in this state.\textsuperscript{22} It becomes obvious, therefore, that the professional corporation, unlike the ordinary business corporation, is subject to the hazard of limited life should all of its shares fall into the hands of persons not authorized to practice law or medicine. However, this particular limitation on the life of the professional corporation seems more imaginary than real since a shareowner who is not authorized to vote or participate in the earnings is not likely to retain such an asset for long. Rather, the professional corporation will probably make provision for disposition of the terminating shareholder's interest through a shareholders' agreement or a provision on the stock certificate calling for a compulsory offer of shares to the corporation or other shareholders.\textsuperscript{23} Such an agreement is desirable because the remaining shareholders will want the power to forestall the possibility of having to work with a person not of their own choosing. Under these circumstances the life of the professional corporation should be considered continuous even though a small possibility of its demise exists.

The Income Tax Regulations take a narrower view of professional corporations by contending that \textit{continuity of life} is lacking if the right to share in profits is contingent upon the shareholder's establishing and maintaining an employment relationship with the organization.\textsuperscript{24} Further, if the shareholder is required to dispose of his interest upon termination of employment or death, the continuing existence of the professional corporation depends upon the willingness or unwillingness of the other members to buy his share or accept the terminating shareowner's proposed successor.\textsuperscript{25} The Commissioner regards this as a limitation on the continuing existence of the professional corporation.

The Louisiana acts, taken alone, would pass the Commissioner's test for \textit{continuity of life}. The statutes do not require an employment relationship for a shareowner to participate in earnings, nor do they require a first refusal clause.\textsuperscript{26} Imposition of these restrictions is left to the discretion of the corporation members who must take into consideration personal preferences and ethical standards.\textsuperscript{27}

\begin{itemize}
\item \textsuperscript{22} Id. 12:805, 905.
\item \textsuperscript{23} Id. 12:806(C), 906(C). Note that under the legislation any restrictions on the transfer of shares must be stated on the stock certificate representing the share.
\item \textsuperscript{24} Treas. Reg. § 301.7701-2(h)(2) (1965).
\item \textsuperscript{25} Id.
\item \textsuperscript{26} LA. R.S. 12:805(B), 905(B) (Supp. 1969).
\item \textsuperscript{27} The American Bar Association has indicated that it is not against pro-
It is perhaps the ethical standards coupled with the desirable results of a first refusal clause which will bring the corporation within the Commissioner's prohibition.

Centralization of Management

The second question is whether the professional corporation has centralization of management. The Louisiana statutes retain centralized management through a board of directors.28

Directors must be voting shareholders.29 Presumably this was legislative recognition of the ethical standards imposed on professionals.30 The powers of management of a professional corporation may well appear to be as encompassing as those of an ordinary corporation. Again, however, ethical considerations have intervened to qualify the directors' powers.31 The most important ethical limitation is that each professional must decide which cases to handle and the procedure for obtaining desired results. The professional must be left to his own designs and not directed to act in a certain way by a central committee. Thus, it can be seen that management of a professional corporation cannot be centralized to the degree possible in an ordinary business corporation.

This limitation is considered by the regulations to be fatal to corporate tax treatment.32 The distinction made by the Commissioner here seems illogical. The regulations measure the viability of a professional corporation's management group against that of the traditional corporation whereas a more logical approach would be to measure it against what ordinary business corporations may do to limit management's authority under state law. A family corporation may find it desirable to limit management power at least as much if not more than ethics and law limit it in a professional corporation. Whether centralized management exists would then turn upon whether there is a valid distinction

---

fessional ethics to incorporate if certain safeguards are provided. 1. Lawyers rendering services to the client must remain personally responsible to the client, and any restrictions on the liability of other lawyers in the organization must be made clear to him. 2. The lawyer must decide which clients to represent and what cases to bring or defend. Therefore, management can be composed of lawyers alone. 3. Non-lawyers should not be allowed to vote shares or participate in earnings in order to prevent division of fees without division of responsibility. ABA Committee on Professional Ethics, Opinion No. 303 (1961). Although the Louisiana statutes do not require an employment relationship to vote or share in earnings, it is implicit that one must exist.

29. Id. 12:810, 910.
30. See note 27 supra.
31. Id.
between limiting management's power by self determination and doing so because ethics and law require it.

**Limited Liability**

The Louisiana legislation states that shareholders of a professional corporation are liable only for the subscription price of their shares. A shareholder is not personally liable for any debt or liability of the corporation. However, as in the ordinary corporation, employees are fully liable for fraud or for any breach of professional duty or for other negligent or wrongful acts. Thus, it would appear that the concept of limited liability is the same as that of an ordinary corporation. Notice to the public that it is dealing with a corporation and that its liability is limited is provided for by requiring the corporate name to end with "A Professional Corporation" or the like. These provisions were indicated by the American Bar Association as necessary to comply with applicable canons of ethics.

The Regulations indicate that a professional corporation lacks the attribute of limited liability if personal liability of its members is greater in any respect than that of a shareholder-employee of an ordinary business corporation. If under local law or rules pertaining to professional practice a mutual agency relationship exists between members, liability is not limited.

Louisiana's status in this regard is unclear. The legislation is sufficiently ambiguous to warrant a reading either way. However, judging from the expressed purpose of having the rules of ordinary corporations apply in the absence of special provision and the presence of the notice giving provision, it seems to have been the intent of the legislature to abrogate the liability rule applicable to partnerships and adopt the rule of liability associated with corporations. Therefore, it appears that under the regulations a Louisiana professional corporation would have limited liability.

**Free Transferability of Interest**

The Louisiana professional corporation acts provide that shares of such a corporation are freely transferable. However,
since only those shareholders authorized to practice their professions in this state may vote shares, engage in management, or share in profits, finding a market may prove difficult.

The Commissioner's position is that for a professional corporation to have free transferability of interest the shareowner must be able to transfer, without the consent of the other members, not only the right to share in profits but also an employment relationship.\textsuperscript{42} The reasoning seems to be that if the right to share in profits is contingent upon the existence of an employment relationship freedom to transfer an interest does not exist in actuality unless both can be sold without the concurrence of the other members. The inclusion of a first refusal clause will be a substantial hindrance upon free transferability of interest because it places transfer determination in the hands of the members of the corporation.\textsuperscript{43}

The Louisiana statutes under consideration apparently do not require an employment relationship to share in earnings or to vote.\textsuperscript{44} License to practice is all that is required. Professional ethics, however, would again seem to demand an employment relationship to prevent the practice of fee-splitting which is forbidden for lawyers and presumably for medical doctors as well. The Commissioner's position seems to be valid since there would seem to be a substantial limitation on the freedom of a shareholder to transfer his interest. A prospective buyer would be reluctant unless assured his investment would yield a return.

Recent Cases

The cases litigating the tax status of professional corporations have been unanimous in deciding that the Kintner Regulations are invalid.\textsuperscript{45} The decisions are based on two grounds. First, the Regulations are discriminatory in that a more strict regulation applies to professionals than to others. Second, the courts have found the Regulations beyond the scope of the Commissioner's authority because the Internal Revenue Code provides that a partnership is something other than an incorporated entity.\textsuperscript{46} Therefore, since these entities are incorporated, they can-

\textsuperscript{42} Treas. Reg. § 301.7701-2(h) (5) (1965).
\textsuperscript{43} Id.
\textsuperscript{44} LA. R.S. 12:805, 905 (Supp. 1969). See also note 27 supra.
\textsuperscript{45} See note 8 supra.
\textsuperscript{46} INT. REV. CODE of 1954, § 7701-(a) (2) : ``(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—''
``(2) Partnership and partners.—The term 'partnership' includes a syndicate,
not be partnerships. The Commissioner argued that state law should not control and that federal law should allow the court to look beyond the form and inquire into the substance as in the *Morrissey* case. The courts indicated that when the entity is incorporated under state law further inquiry is unnecessary, for this would go beyond the legal requirements.47

Final determination of this issue is not far off. The recent flurry of cases and their successful outcome is bound to stimulate new interest among the professionals. The Commissioner will be obligated to litigate the issue until a final determination is reached. In the end there may be action by Congress. In the past Congress has not chosen to detail an objective definition of corporation.48 However, certain corporations have been singled out to be taxed in a particular way, such as personal holding corporations,49 insurance companies,50 and investment companies.51 From this it can be seen that the pattern heretofore established by Congress has not been to create a federal definition of corporateness but instead to deal with particular problems as they arise by amendment to the Code. The creation and regulation of corporations have unquestionably always been legitimate activities of the states.52 If the court continues to hold professional corporations taxable as regular corporations, any change must come from Congress either by special provision or by expanding the Code's definition of corporateness to thus give that term a federal meaning apart from state law.

CONCLUSION

Although, at the present time, the way seems clear for professionals to incorporate, there are hazards involved should the current trend reverse. Beyond the risk of being drawn into extended litigation with the Commissioner and the possibility of Supreme Court reversal of the lower courts, there is the hazard that professional corporations will be regulated either by Congress, under the taxing authority, or by the Louisiana Supreme

47. A broad policy question which may be asked is whether the various state legislatures should have the power to interfere with the federal taxing authority by passing legislation having no object other than providing a means of avoiding a federal tax. Are not the states which have passed professional corporation acts really regulating the incident of tax?

48. INT. REV. CODE of 1954, § 7701-(a) (3).

49. *Id.* §§ 541-547.

50. *Id.* §§ 801-843.

51. *Id.* §§ 851-855.

52. See Empey v. United States, 406 F.2d 157 (10th Cir. 1969).
Court, or Board of Medical Examiners, under their power to regulate the respective legal or medical professions.53

The chance that these hazards will materialize seems small, and the more aggressive professionals may wish immediate corporate status. Others may assume a wait-and-see approach while taking advantage of a congressionally approved pension plan under H.R. 10.

It would seem desirable for Congress to take the initiative to relieve professionals and other self-employed persons from having to change their organizational form solely to gain a tax advantage now available to others. Nothing in the literature advances any reason why the corporate form should enjoy tax advantage over other forms of business. This anomalous situation creates not only a discriminatory effect on tax liability but also an undue burden on those incorporating purely for tax benefits.

Larry J. Gunn

DUTY OF CORPORATE OFFICERS AND DIRECTORS IN LOUISIANA

"Officers and directors shall be deemed to stand in a fiduciary relation to the corporation and its shareholders, and shall discharge the duties of their respective positions in good faith, and with that diligence, care, judgment and skill which ordinarily prudent men would exercise under similar circumstances in like positions."1

Thus Section 91 of the new Louisiana Business Corporation Law defines the duty of corporate officers and directors in Louisiana. It is identical with Section 36 of the 1928 Corporation Act2 with the notable exception that it specifically extends the fiduciary relationship of officers and directors to shareholders. The 1928 provision was in turn taken almost verbatim from the Model Business Corporation Act.3 The Commissioners’ Notes to the Model Act point out it was necessary to specify the standard of care to which officers and directors would be held due to the conflict among decisions.4 Prior to 1928, some courts interpreting

3. Model Bus. Corp. Act § 33 (1928). This Model Act is also known as the Uniform Business Corporation Act and was adopted by the National Conference of Commissioners on Uniform State Laws in 1928. It is to be distinguished from the later ABA-ALI Model Business Corporation Act.
4. 5 LA. REV. STAT. ANN. 225 Comment (West 1951).