6-1960

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Recommended Citation
Jerry B. Martin, Tax and Other Legal Aspects of the Corporate Practice of Medicine, 13 Vanderbilt Law Review 744 (1960)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol13/iss3/10

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libel is injury to reputation, the notion that it is pecuniary loss, presumed or otherwise, is ingrained into a large portion of modern judicial thinking. The ultimate significance of this may be an eventual abandonment of the distinction between injurious falsehood and defamation, and the treatment of all actions based upon words as either libel or slander.

ALFRED H. KNIGHT, III

TAX AND OTHER LEGAL ASPECTS OF THE CORPORATE PRACTICE OF MEDICINE

A clear and concise statement of the general rule concerning the corporate practice of medicine is found in 13 American Jurisprudence, as follows:

Section 837. While a corporation is in some sense a person and for many purposes is so considered, yet, as regards the learned profession which can only be practiced by persons who have received a license to do so after an examination as to their knowledge of the subject it is recognized that a corporation cannot be licensed to practice such a profession.

A corporation cannot be licensed to carry on the practice of medicine. Nor, as a general rule, can it engage in the practice of medicine, surgery, or dentistry through licensed employees.

Despite this prevailing rule many medical practices have taken on the corporate form. Charitable and university hospitals which hire and pay salaries to doctors who treat patients are numerous. Large corporations employ medical staffs and build hospitals in order to furnish medical care for their employees. Also many health insurance plans and groups of physicians practicing in clinics are set up in the corporate form. More often than not the legality of these practices has not been questioned by the courts and even when questioned the practices are upheld.

72. See note 64 supra.

73. This abandonment seems to have already in effect occurred in libel cases where the language is non-defamatory, and the court holds that it is not libelous per se, but permits recovery on the basis of special damages. E.g., Koerner v. Lawler, 180 Kan. 318, 304 P.2d 926 (1956); Barteck v. Personal Fin. Co. of Toledo, 60 Ohio App. 197, 20 N.E.2d 259 (1938).

1. Laufer, Ethical and Legal Restrictions on Contract and Corporate Practice of Medicine, 5 Law & Contemp. Pros. 516 (1939); Note, 7 Geo. Wash. L. Rev. 120 (1939); Note, 7 Geo. Wash. L. Rev. 120 (1939); Note, 3 Vill. L. Rev. 548 (1938); Note, 3 Vill. L. Rev. 548 (1938); Note, 17 N.C.L. Rev. 183 (1959).

2. See 1 Fletcher, Corporations § 2525 (1939).

In view of the exceptions being made to the general rule and also the apparently direct violations thereof, it is felt a discussion of the reasons for the rule and the arguments against it would be timely.

Basically, the rule against the corporate practice of medicine is designed to prevent any interference with the confidential relationship between a doctor and his patient and any usurpation of the loyalty a doctor owes his patient by a corporate entity.\(^4\) Another strong underlying reason for the rule is that corporate management could give laymen control over physicians which could result in commercial exploitation of the profession.\(^5\) In the great majority of states, there is no statute expressly prohibiting the corporate practice of medicine. The rule is usually enforced by court interpretation of a medical licensure statute.\(^6\) Most often the statute authorizes licensing of certain “persons”; the courts interpret this to mean only human beings and so deny licenses to corporations.\(^7\)

The corporate practice rule has been criticized as a legal fiction since the courts apply it only when faced with exploitation of the doctor’s skills by a corporation in a “profit-taking” scheme which would have a general adverse effect on public health.\(^8\) This position is strongly supported by the fact that only two cases have been found where corporate practices by non-profit organizations have been held illegal.\(^9\) This position also finds support in numerous cases\(^10\) and

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6. This article does not undertake to cite and analyze the positions of every state on this subject, but a comprehensive study of the state standings on the problem can be found in **AMA Bureau of Legal Medicine and Legislation, A Study Relating to the Corporate Practice of Medicine in the United States** (1956).
9. Willcox, **Hospitals and the Corporate Practice of Medicine**, AHA Hospital Monograph Series No. 1 (1957). The author cites as the only clear exception an unreported Iowa case, Iowa Hosp. Ass'n v. State Bd. of Med. Examiners, Nov. 28, 1955. A more dubious exception, also unreported, is Spears Free Clinic v. Denver Better Business Bureau, District Ct. Colo., Oct. 1955, since there was a strong suspicion of quackery on the part of the clinic.
10. United States v. American Medical Ass’n, 110 F.2d 703, 714 (D.C. Cir. 1940), aff’d, 317 U.S. 519 (1943). The court stated: “[I]n all the cases we have examined in which the practice has been condemned, the profit objective of the offending corporation has been shown to be its main purpose . . .” Group Health Ass’n v. Moor, 24 F. Supp. 445, 446 (D.D.C. 1938); Complete Serv. Bureau v. San Diego County Med. Soc’y, 43 Cal.2d 201, 209, 272 P.2d 497, 501 (1954); See also People v. Pacific Health Corp., 12 Cal.2d 156, 160, 82 P.2d 459, 431 (1938); Group Health Co-op v. King County Med. Ass’n, 39 Wash.2d 586, 603, 237 P.2d 737, 778 (1951).
opinions of state attorneys general. It would seem therefore that the courts have added an exception to the rule which is all but universally accepted. There are those, however, who believe the rule should be abolished or at least have its application limited so as not to include hospitals or corporations composed entirely of medical practitioners.

Most often the agreement over the merits of the corporate practice rule finds the physician and the American Medical Association in favor of the rule against the corporate practice of medicine and the hospitals and the American Hospital Association against the rule. The physicians, however, have at times been heard to decry the inequity of a federal income tax scheme which will not allow them to take advantage of employee pension plans so as to defer taxation on a part of their income until they have retired. These pension plans could only be utilized by a physician if he was an employee and in states which prohibited the corporate practice of medicine he could not be an employee.

The requirements of a qualified pension, profit-sharing, and stock bonus plans are set out in section 401 of the Internal Revenue Code of 1954. Section 402, on the taxability of beneficiaries of employees' trusts, provides that the beneficiary of the plan will be taxed only on the amount actually distributed or made available to him in the year so distributed or made available. He will not be taxed on the employee's contribution even though the employer may deduct the contribution in the year paid. Thus, it is possible for an employee to take advantage of this income-spreading device and postpone the taxation of a part of his income until he retires while also getting a lower tax bracket in the year the income is earned.

Under new proposed regulations promulgated by the Internal Revenue Service, the tax benefits of section 402 are now available to an association of physicians in those states where the corporate practice of medicine is illegal. In short the Commissioner of Internal Revenue now takes the position that, regardless of whether an "association" of doctors is a corporation under local state law, if the organization meets the criteria of his new regulations it will be

12. See Laufer, supra note 1; Willcox, op. cit. supra note 3.
14. INT. REV. CODE OF 1954, § 802(a) (1).
15. INT. REV. CODE OF 1954, § 404.
16. The prerequisites for a qualified plan are set out in INT. REV. CODE OF 1954, § 401 and certain limitations on the deductibility of employer's contributions are provided in § 404 but in spite of these restrictions a sizable tax saving may still be obtained.
18. See note 14 supra.
treated as a corporation for purposes of qualifying an employee pension plan for the favorable tax treatment under section 402. In view of the extended and expensive training period and the comparatively short productive career, during which a physician is in an extremely high tax bracket, the value of deferring taxation on a portion of his income until his later and less productive period of life is obvious. For a clear understanding of the new regulations, it will be necessary to trace their historical development.

The provision of the Internal Revenue Code making this income-spreading device available to employees is the same in both the 1939 and 1954 Codes, but the difficulty has arisen over the failure of the statute to define the term “employee.”

In 1939 and 1940 the Internal Revenue Service ruled that neither an individual proprietor nor a partner qualify as an “employee” so as to be able to take advantage of this plan. Thus the physician seeking to utilize this income-spreading plan could do so only by organizing a corporation or hiring himself out professionally to a corporation. In either event he faced the wrath of the medical association or, in most states, the rule against the corporate practice of medicine and perhaps both. However, the definitional section of both the 1939 and 1954 Codes seemed to make it possible for a group of doctors to join themselves in a private association—neither corporation nor partnership under local law—which would be taxable as a corporation since the latter is defined as including an “association.” In the case of Burk-Waggoner Oil Ass’n v. Hopkins, the Supreme Court held that an unincorporated association which transacts business as if it were incorporated is taxable as a corporation. The Court has also held that an association may be taxed as a corporation even though it is not recognized as a legal entity under local law and despite the fact that its stockholders remain individually liable for its debts. In deciding the case of Morrissey v. Commissioner, the Supreme Court undertook to state the criteria which would qualify an association for tax treatment as a corporation. These criteria which apparently were the source of the new regulations were as follows:

1. The entity should hold the property embarked in the corporate undertaking.
2. There should be centralized management.
3. It should be secure from termination or interruption by death.

23. 269 U.S. 110 (1925).
26. The proposed regulations cite the Morrissey case as authority.
of an owner.

4. Beneficial interest should be transferable without affecting the continuity of the enterprise.

5. Personal liability of the participants should be limited.\textsuperscript{27}

Organizations having the characteristics set out in the \textit{Morrissey} case have gained the name by which they are known, not from that case, but from \textit{Kintner v. United States}.\textsuperscript{28} In the \textit{Kintner} case eight doctors who had theretofore practiced as partners formed an association. Their association established an employee pension trust, the member doctors assuming that they were employees. The Commissioner of Internal Revenue ruled that any contribution to the trust by the association was income to the doctors and taxable as such. The court, while holding that the association was taxable as a corporation under then-existing definitions of "association" and "partnership" in the regulation, approved the criteria of \textit{Morrissey}.\textsuperscript{29} In this connection the court stated that even though the association met only three of the above tests it nevertheless more closely resembled a corporation than a partnership so that the doctors could be classified as employees for tax purposes.\textsuperscript{30} It should be noted that a corporation could not legally engage in the practice of medicine under the laws of Montana,\textsuperscript{31} a further indication that local state laws are not determinative of classification for federal tax purposes.

Soon after this decision was affirmed by the ninth circuit,\textsuperscript{32} the Internal Revenue Service published a notice of nonacquiescence.\textsuperscript{33} The next year, however, the Commissioner reversed himself on this point and in the language of this ruling he accepted the \textit{Kintner} result unequivocally:

It is now the position of the Service that the fact that an association establishes a pension plan under section 401(a) of the Internal Revenue Code of 1954 . . . is not determinative of whether such organization will

\textsuperscript{27} 296 U.S. 344, 359 (1935).
\textsuperscript{28} 107 F. Supp. 976 (D. Mont. 1952). See also Galt v. United States, 175 F. Supp. 360 (N.D. Texas 1959), which cites the \textit{Kintner} case.
\textsuperscript{29} 107 F. Supp. at 976, 979.
\textsuperscript{30} For a discussion of this case, see 40 Iowa L. Rev. 663 (1955); Mackay, \textit{Pension Plans and Associations Taxable as Corporations for Professional Persons}, 10 Sw. L.J. 281 at 282 (1956).
\textsuperscript{31} A corporation can not meet the requirements of the Montana licensing statute. \textit{Mont. Rev. Codes Ann.} § 66-1003 (1947). See also Pelton v. Commissioner, 82 F.2d 473 (7th Cir. 1936), in which the court held a trust that was established by a group of doctors taxable as a corporation although in Illinois where the trust was established it was illegal for a corporation to practice medicine. It is interesting to note that in the Pelton case the Commissioner was in favor of the trust being taxed as a corporation, inconsistent with his position in \textit{Kintner}.
\textsuperscript{32} United States v. Kintner, 216 F.2d 418 (9th Cir. 1954).
be classified as a partnership or an association taxable as a corporation. The usual test will be applied in determining whether a particular organization of doctors or other professional group has more of the characteristics of a corporation than a partnership.34

This ruling further stated that the criteria to be used in establishing an association taxable as a corporation would be published at a later date. The proposed regulations35 listed the criteria to be used in determining whether an organization is to be considered an "association," defined many terms which might be subject to misconstruction,36 and cited examples of how certain types of organizations would be classified.37

Although some difficulties may arise under these new regulations, they give clear and useful guidelines to doctors wishing to take advantage of the income-spreading procedures of section 402 and the professional organizations formed for this purpose should be acceptable to the medical association. Also, in view of the decision of the Supreme Court in the Morrissey case, judicial approval is almost assured. These regulations probably will not be effective until 1961,38 but they represent the views of the Internal Revenue Service so it would seem a taxpayer could safely act under them.39

Even though these "associations" have not legally incorporated, they often so resemble a corporation that any other type organization would be called a de facto40 corporation or corporation by estoppel.41 In such case they would have violated the rule against practice in the corporate form of many states and would be subject to an injunction or even a fine. However, as has been stated earlier,42 such practices probably will not be questioned if the entire organization is managed and staffed by doctors.

As a general rule, in the absence of statute, unincorporated associations cannot sue or be sued in the association name, but an action may be brought against the association for torts of an agent acting within the scope of his employment if brought against the aggregate members

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35. Note 17 supra.
39. In spite of the tax advantages which doctors gain through the "unincorporated association," such an organization has been called hazardous in at least one publication, SHARTEL & PLANT, THE LAW OF MEDICAL PRACTICE 256 (1959). The authors state that such an organization may be called a corporation on one occasion and a partnership on another, usually to the disadvantage of the members and the person who undertakes leadership may be held personally liable for group activities, as an employer.
40. BALLANTINE, CORPORATIONS § 21 (1946).
41. BALLANTINE, CORPORATIONS § 31 (1946).
42. See note 3 supra.
of the association. It is most likely that this rule will be applied to an unincorporated association of doctors even though it sufficiently resembles a corporation to get the above tax advantages. It is not improbable, however, that the courts will rule that the associations are de facto corporations or corporations by estoppel and allow the suit in the corporate name. In either event the basis of the vicarious liability of the association or its members for the torts of its employees is respondeat superior, and there is no vicarious liability if the employee is merely an independent contractor.

With the coming of regulations allowing doctors the tax advantages of corporate employees, the doctors will probably be more solidly behind the positions of the AMA in favor of the prohibition against the corporate practice of medicine. For example, at least one state group, the Tennessee State Medical Association, has recently adopted a resolution against practicing medicine in the corporate form, and there have been no recent reports of state associations taking the opposite position. The American Hospital Association which seems to lead the opposition to the corporate practice rule does not attack the rule as being intrinsically bad but takes the position that it is being incorrectly applied. It is insisted by this group that when a corporation receives payments for the professional services of a physician it does not necessarily follow that the corporation is engaging in the practice of medicine. This statement could very easily hold a solution to the problem which would be acceptable to both sides. The solution would not abolish the rule but limit and clearly define its application by a list of exceptions: First of all, it would seem possible to allow non-profit corporations and corporations managed and staffed entirely by doctors to engage in the practice of medicine since from all indications they do so in spite of the rule; and secondly there seems to be no valid agreement against allowing doctors to be "employed" by hospitals as long as the capacity in which they serve is that of an independent contractor. Thus the doctor would be a physician first with his first loyalty to his patient controlled by the rules of the American Medical Association, while the hospital would handle the administrative problem and receive the

45. Resolution of Tennessee State Medical Ass'n (April 12, 1960), to be reported in Vol. 53, No. 6 Journal of the Tennessee Medical Ass'n (June 1960).
46. The pamphlet cited in Note 3 supra contains an excellent discussion of pros and cons of the rule from the standpoint of the American Hospital Association.
47. Note 3 supra, at 30.
48. Note 10 supra.