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Clarification of "Association" for Corporate Tax Purposes: The Proposed Kintner Regulations

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CLARIFICATION OF "ASSOCIATION" FOR CORPORATE TAX PURPOSES: THE PROPOSED KINTNER REGULATIONS

The proposed Kintner Regulations are an attempt by the Internal Revenue Service to define what constitutes an association for purposes of corporate taxation. Congress, for tax purposes, has defined the term corporation to include *associations,* joint stock companies and insurance companies.[1] At the same time it has defined a partnership to include a "syndicate, group . . . or other *unincorporated organization,* through or by means of which any business . . . is carried on, *and which is not . . . a trust or estate or a corporation. . . .*"[2] Congress has thus established two mutually exclusive categories of business enterprise but has gone no further in defining the statutory terms. The Kintner Regulations enumerate the characteristics that an association of lawyers, doctors, real estate investors, investment club members and other business enterprises must possess to determine its tax treatment as a partnership, trust or corporation.

Background of the Regulations

The current regulations encompass principles and concepts that have had their background in case law. In 1925, the United States Supreme Court held that Congress possessed the power to tax an unincorporated association as a corporation if it transacts its business as if it were incorporated.[3] Ten years later, the Supreme Court in *Morrissey v. Commissioner,*[4] which is cited in the Kintner Regu-

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[1] INT. REV. CODE OF 1954, § 7701(a)(3) [hereinafter cited as CODE]. In BOUVIER, A CONCISE ENCYCLOPEDIA OF THE LAW (8th ed. 1914), the term association is defined "to signify a body of persons united without a charter but upon the methods and forms used by incorporated bodies for the prosecution of some enterprise." See Driscoll, *The Association Problem in Joint Ventures and Limited Partnerships,* N.Y.U. 17TH INST. ON FED. TAX 1067 (1959). The concept of association is vague and does not contain a clearly recognized legal content. *Id.* at 1072.

[2] CODE § 7701(a)(2). (Emphasis added.)

[3] Burk-Waggoner Oil Ass'n v. Hopkins, 269 U.S. 110 (1925). See also Mackay, *Pension Plans and Associations Taxable as Corporations for Professional Persons,* 10 Sw. L.J. 281, 288 (1956).

[4] 296 U.S. 344 (1935).

lations,[5] established the landmarks for distinguishing an association or other unincorporated entity taxable as a corporation, from one taxable as a partnership.[6] These characteristics included:

(1) Two or more associates.
(2) An enterprise to carry on business for profit.
(3) Ownership of the property by the entity, separate from the persons with beneficial interests.
(4) A continuing body with provisions for succession.
(5) Centralized management through representatives of the members of the corporation.
(6) Transferability of interests.
(7) Limitation of personal liability of the participants to the property involved in the undertaking.[7]

The Court did not specify which characteristics were to be essential, but rather, employed the "resemblance" test. "The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity. The resemblance points to features distinguishing associations from partnerships as well as from ordinary trusts." [8] This statement has been the keynote of subsequent decisions.[9] It means that where an entity resembles a corporation in some respects and also contains partnership attributes, then the *Morrissey* test would require that the features of similarity be compared, and marks of dissimilarity contrasted. The resemblances would then be balanced. Under this test, the one to which the association is more closely related in method, mode and form of procedure in its business conduct, will determine its manner of taxation.[10]

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[5] Proposed Treas. Reg. § 301.7701-2(a); 24 Fed. Reg. 10451 (1959) [hereinafter cited as Proposed Regs.].

[6] Mackay, *supra* note 3, at 288.

[7] Morrissey v. Commissioner, 296 U.S. 344 (1935). See SURREY & WARREN, FEDERAL INCOME TAXATION 990-96 (1955 ed.). The *Morrissey* case concerned the taxation, as associations, of various forms of trusts and not partnerships. But the *Morrissey* case made it clear that it was defining the association concept without limiting it to trusts. As a result the *Morrissey* case is invoked in partnership areas as well as trusts.

[8] Morrissey v. Commissioner, *supra* note 7, at 357. For a further interpretation of the *Morrissey* case, see Guaranty Employees Ass'n v. United States, 241 F.2d 565 (5th Cir. 1957). See also 7 MERTENS, LAW OF FEDERAL INCOME TAXATION § 38A.14, wherein questions as to the corporate form have revolved about the salient features of a corporation as indicated in the *Morrissey* decision; Porter v. Commissioner, 42 B.T.A. 681 (1940). The *Morrissey* case teaches that the statute is intended to include a trust, even strict in form, if it is at the same time conducted for profit. *Id.* at 690.

[9] MERTENS, *supra* note 8, at § 38A.14. See also Guaranty Employees Ass'n v. United States, *supra* note 8. The tests that the Court suggests in *Morrissey* "all go to the point of whether the trust is being used to achieve the organizational conveniences of the corporate form—in which case it should be taxed as a corporation." *Id.* at 571.

[10] Bert v. Helvering, 92 F.2d 491 (D.C. Cir. 1937); *accord,* Commissioner v. Brouillard, 70 F.2d 154 (10th Cir. 1934).

In 1954, the Ninth Circuit, in *United States v. Kintner,*[11] outlined the problem in relation to the professional association, treating the association as a corporation for tax purposes. In that case, the taxpayer was a doctor who for many years was a member of a copartnership. The partners dissolved the partnership and executed articles of association whereby they sought to become members of an unincorporated association.[12] The purpose was to qualify them as employees in order to meet the requirements of a qualified pension plan under section 401 of the Code.[13] The court held the association was to be taxed as a corporation, finding that the enterprise had the characteristics of a corporation to an extent sufficient to be treated as such. All the substantial points of resemblance to a corporation were present in the taxpayer's enterprise, while there were substantial dissimilarities to the partnership form.[14] The Internal Revenue Service expressly rejected the *Kintner* doctrine. The rationale was that a group of doctors who adopt the form of an association to obtain section 401 benefits is in substance a partnership and therefore they could not be considered employees.[15] This position contradicted prior statutory interpretation. As a result, in 1957 the Service announced that the usual tests will be applied in determining whether a particular organization of doctors, or other professional groups, has more characteristics of a corporation than of a partnership. If it does, it will be treated as a corporation for *all* tax purposes.[16]

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[11] 216 F.2d 418 (9th Cir. 1954).

[12] The association agreement and characteristics provided that it be endowed with corporate attributes, be treated as a corporation for tax purposes and be terminated on the death of the last survivor. It provided also that duly licensed physicians could become members, with management centralized in an executive committee. Any indebtedness incurred by the association through the act of a member without authority of the committee was to be chargeable against a member's share of the earnings. United States v. Kintner, *supra* note 11, at 420.

[13] CODE § 401. For a discussion in this area, see text accompanying notes 67-70, *infra*.

[14] United States v. Kintner, *supra* note 11, at 422. The court was citing from Pelton v. Commissioner, 82 F.2d 473 (7th Cir. 1936).

[15] Rev. Rul. 56-23, 1956-1 CUM. BULL. 598. The Commissioner has listed three objections to having associations taxable as corporations for professional persons: first, professional persons practicing their professions are not engaged in a "business" since profits are solely from services and not a business; second, the purpose of the association must be one that it could have had under local law; third, professional persons are not to be considered employees of the association and therefore cannot qualify for the pension plan. Mackay, *Pension Plans and Associations Taxable as Corporations for Professional Persons,* 10 Sw. L.J. 281, 290-93 (1956).

[16] Rev. Rul. 57-546, 1957-2 CUM. BULL. 886.

The Regulations and Local Law

Under the Regulations, it is the Internal Revenue Code and not local law that establishes the tests or standards for tax purposes.[17] A particular organization may be classified as a trust in one state or as a corporation in another. For tax purposes this organization will be uniformly classed, depending on the characteristics which it possesses.[18] In some states, professional persons such as doctors or lawyers are prohibited by state law from forming a corporation for the practice of their profession.[19] Nevertheless, if the association meets the standards set down by the Regulations, the association will be a corporation for tax purposes.[20] "The act of a state can neither raise nor lower the federal taxes that may be due by the association by whatever name it may be called under the laws of a particular state."[21] Through this rule of law, there is secured the uniformity essential to the federal tax system. It enables equal treatment for taxpayers no matter in what state their activities are carried on.[22]

The Kintner Regulations do not totally ignore local law. Local law governs to determine if the legal relationships which have been established in the formation of an organization are such that the standards are met. Local law will determine the legal relationships of the members among themselves and the public, and the interests the members of the enterprise have in its assets.[23]

The Regulations and the Corporate Factors

The Kintner Regulations enumerate the corporate characteristics that the enterprise must possess to be classified as a corporation, rather than an organization such as a partnership or trust. Those characteristics are:

(1) Associates.
(2) An objective to carry on business and divide the gain therefrom.

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[17] Proposed Regs. § 301.7701-1(c).

[18] *Ibid.* See also Treas. Reg. 118, § 39.3797-1 (1953). "Local law is of no importance. . . ." *Ibid.* For a modification of this concept, see note 23 *infra* and accompanying text.

[19] See, *e.g.*, N.Y. Stock Corp. Law § 7, prohibiting the incorporation of a law firm.

[20] See Galt v. United States, 175 F. Supp. 360 (N.D. Tex. 1959), wherein doctors who were not permitted to incorporate under Texas law were held taxable as a corporation.

[21] *Id.* at 362; *accord,* United States v. Kintner, 216 F.2d 418 (9th Cir. 1954). The court stated "it would introduce an anarchic element in federal taxation if we determined the nature of associations by State criteria rather than . . . criteria sanctioned by the tax law. . . ." *Id.* at 424; Pelton v. Commissioner, 82 F.2d 473 (7th Cir. 1936).

[22] United States v. Kintner, *supra* note 21, at 424.

[23] Proposed Regs. § 301.7701-1(c).

(3) Continuity of life.
(4) Centralization of management.
(5) Liability for corporate debts limited to corporate property.
(6) Free transferability of interest.[24]

There may be added factors significant in classifying an organization as an association, partnership or trust. In the last analysis, the Regulations embody the *Morrissey* principle. "An organization will be treated as an association if the corporate characteristics are such that the organization *more nearly resembles* a corporation than a partnership or trust." [25] The Regulations proceed to define in detail what is meant by continuity of life, centralization of management, limited liability and transferability of interests.[26] This is followed by a section on partnerships in conjunction with the factors enumerated. That is, a partnership will include groups and other unincorporated organizations that are not corporations or trusts. The partnership must be analyzed to determine if it has such characteristics so as to give it corporate status.[27]

The classification of *limited* partnerships was in doubt due to *Glensder Textile Co. v. Commissioner.*[28] A limited partnership organized under the Uniform Partnership Law of New York, was held taxable as a partnership despite taxpayer's resemblance in some particulars to a joint stock association. The line of determination was one of fact dependent on the powers conferred. It was pointed out that while there was centralized control by the general partners, they were not analogous to corporate directors since they owned a substantial share of the partnership and did not act in a mere representative capacity. As to continuity of existence, the agreement provided that in the event of the death of a general partner, the survivors would continue the business. The Board said this was a contingent continuity of existence since it would only become certain if all the general partners agreed to it. A general partner could not

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[24] Proposed Regs. § 301.7701-2(a). "Whether a particular organization is to be classified as an association must be determined by taking into account the presence or absence of each of these corporate characteristics." *Ibid.*

[25] *Ibid.* (Emphasis added.)

[26] Proposed Regs. § 301.7701-2(b), (c), (d), (e). (See *e.g.,* § 301.7701-2(b)(1) which states that an organization possesses continuity of life if the death, bankruptcy, insanity, retirement, resignation or expulsion of any member will not dissolve the organization. Under Proposed Regs. § 301.7701-2(c)(3), centralized management means a concentration of continuing exclusive authority to make independent business decisions on behalf of the whole without the necessity of ratification. By virtue of Proposed Regs. § 301.7701-2(e), an organization has transferability of interests, if each member or those members owning most of the interests have the power, without the consent of other members, to substitute for themselves a person who is not a member of the organization. All the attributes of his position must be capable of being conferred on the substitute.

[27] Proposed Regs. § 301.7701-3.

[28] 46 B.T.A. 176 (1942).

transfer his interest and, although a limited partner could transfer his interest, the Board felt that no mechanics were provided for the ready transfer of interest through certificates. Finally, limited liability of the limited partners was not a controlling factor since the general partners possessed unlimited liability. The court examined the powers and liabilities of this limited partnership and concluded that a characterization as an association was not justified.[29] Regulations following the *Glensder* opinion [30] and the Kintner Regulations [31] look to the corporate factors that the limited partnership possesses and not to its qualifications under state law. It would appear that a limited partnership as characterized in *Glensder,* would still be treated as a partnership for tax purposes. If this limited partnership possessed the added features of continuity of life and centralized management, the Kintner Regulations would be applicable.

Trusts Under the Regulations

The last major segment of the Regulations relate to the circumstances under which a trust will be classified as an association and hence, as a corporation for income tax purposes.[32] The Regulations distinguish between ordinary trusts and business trusts. The ordinary use of the term "trust" refers to an arrangement created by will or inter vivos declaration. Title is in the trustees to manage and protect the property for the beneficiaries.[33] This would not qualify as an association under the Regulations. The rationale is that an association implies associates. It implies entering into a joint enterprise for a business transaction, which is not common to an ordinary trust.[34] Qualifying trusts are called business or commercial trusts and are created by the beneficiaries to carry on a profit-making business usually accomplished by partnerships or corpora-

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[29] *Ibid.* See also Western Constr. Co. v. Commissioner, 14 T.C. 453 (1950).

[30] Treas. Reg. 118, § 39.3797-5 (1953), provided that even though a limited partnership may be organized under the provisions of the Uniform Limited Partnership Act, it may still be a partnership or an association depending on whether the essential characteristics of an association are met.

[31] Proposed Regs. § 301.7701-3(a)(b). For a discussion of the limited partnership, see SURREY & WARREN, FEDERAL INCOME TAXATION 994 (1955 ed.). The regulations formerly distinguished between limited partnerships, such as those formed under the New York statute, and the limited partnerships authorized by statutes of Pennsylvania and Michigan. The latter provide for the limitation of liability of *all* partners. The New York statute minimizes the liability of *limited* partners only, and they were regularly taxed as general partnerships. However, this was later changed so that even the New York type of limited partnership may be taxable as an association depending on whether the corporate characteristics exist. *Ibid.*

[32] Proposed Regs. § 301.7701-4.

[33] *Ibid.*

[34] See Morrissey v. Commissioner, 296 U.S. 344, 356-57 (1935); Main-Hammond Land Trust v. Commissioner, 200 F.2d 308, 311-12 (6th Cir. 1952).

tions.[35] Though the corpus of the business trust is not supplied by the beneficiaries, this would not be a sufficient factor in itself for classifying the arrangement as an ordinary trust.[36] To permit a trust to be classified as an association, the substantive element is that the trust be initially created or have subsequently been utilized during the tax period as a vehicle for the maintenance of a business enterprise.[37] The second and supportive element is that the trust must have the characteristics of an association either under its written structure or adopted mode of operation resemblant of the corporate structure.[38] Both these categories are requisite and are characterized under the Regulations.[39] It is the purpose and operation of the trust that control.[40]

The business motive and the corporate criteria are further developed in the companion cases to *Morrissey* where trusts were held to be taxable as associations.[41] The trust will be given such corporate status though there are limited numbers of actual beneficiaries and the operations of the trust limited to real property first acquired. These factors could not alter the business motives of the enterprise.[42] Where the trustees do not exercise all the powers under the trust agreement, the parties are not at liberty to declare another or narrower purpose than which they formally set out in their instrument.[43] These decisions have effectively limited the use of a trust by beneficiaries to carry on a business operation.

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[35] Proposed Regs. § 301.7701-4(b). Whether the characteristic of free transferability of interest is common in such trusts may be questioned. In an example given in the Regulations, a grantor transferred a department store to his two eldest sons, designated by the agreement as trustees. One of the provisions stated that every member has the right to transfer his interest to a particular person who is not a member of the organization only if he advises the organization of the proposed transfer and gives them an opportunity to purchase at the fair market value. Such an organization has a modified form of transferability of interest. Proposed Regs. § 301.7701-4(c), example 2.

[36] Proposed Regs. § 301.7701-4(b).

[37] Anderson v. Lamb, 120 F. Supp. 99 (D.N.D. 1954).

[38] *Ibid.*

[39] See Proposed Regs. § 301.7701-2.

[40] Commissioner v. Vandergrift Realty & Inv. Co., 82 F.2d 387 (9th Cir. 1936). The Kintner Regulations further provide for certain investment trusts and for liquidating trusts. § 301.7701-4(d), (e). "A liquidating trust is treated as a trust for purposes of the Internal Revenue Code because it is formed with the objective of liquidating particular assets and not as an organization having as its purpose the carrying on of a profit making business. . . ." § 301.7701-4(e).

[41] Helvering v. Coleman-Gilbert Assoc., 296 U.S. 369 (1935); Helvering v. Combs, 296 U.S. 365 (1935); Swanson v. Commissioner, 296 U.S. 362 (1935). Note that in all three cases, all the required characteristics were present.

[42] Swanson v. Commissioner, *supra* note 41, at 365. The trust was formed by the owners of an apartment house; *accord,* Helvering v. Combs, *supra* note 41, at 368, where the essential features of the enterprise were not affected by the confinement of operations to one oil well.

[43] Helvering v. Coleman-Gilbert Assoc., *supra* note 41, at 374.

What Characteristics Are Essential Under Prior Authorities

The courts have dismissed the lack of formal aspects of a corporation as not being a controlling factor.[44] The use of corporate forms and terminology may furnish persuasive evidence of the existence of an association; but the fact that meetings are not held nor corporate procedure employed,[45] or there are no officers nor by-laws [46] is not conclusive. Although corporate procedure need not be followed, neither the *Morrissey* opinion nor the Kintner Regulations stipulate which of the enumerated characteristics are essential to have association status.

Prior to the Kintner Regulations various authorities had attempted to define the essential factors. The holding of title in the name of the business entity, the third characteristic in the *Morrissey* case, is not a relevant factor,[47] and is not included in the Kintner Regulations.[48] Limitation of liability has been eliminated as a controlling characteristic. Even though the Supreme Court in all four companion cases [49] mentioned limitation of liability as one of the elements present in those cases, it "is not the vital and conclusive factor under the terms of the tax act, or that the Supreme Court intended in its four opinions to make it an indispensable element in cases of this sort." [50] Authorities are in conflict in determining if transferability of interest is indicative of association status,[51] while centralization of management and continuity of life are essential.[52]

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[44] Morrissey v. Commissioner, 296 U.S. 344 (1935); *accord,* Driscoll, *The Association Problem in Joint Ventures and Limited Partnerships,* N.Y.U. 17TH INST. ON FED. TAX 1067, 1073-74 (1959).

[45] Pelton v. Commissioner, 82 F.2d 473, 476 (7th Cir. 1936); Helvering v. Coleman-Gilbert Assoc., *supra* note 41.

[46] Morrissey v. Commissioner, *supra* note 44.

[47] Driscoll, *supra* note 44, at 1075.

[48] Proposed Regs. § 301.7701-2.

[49] This reference is to the *Morrissey* case and the three cases cited in note 41 *supra.*

[50] Bert v. Helvering, 92 F.2d 491, 495 (D.C. Cir. 1937). In the *Bert* case, a group of associates joined together for the purpose of speculating in Sears & Roebuck stock with the element of limitation of liability not being clearly present. *Accord,* Cooper v. Commissioner, 262 F.2d 530 (10th Cir. 1958), *cert. denied,* 359 U.S. 944 (1959); Driscoll, *The Association Problem in Joint Ventures and Limited Partnerships,* N.Y.U. 17TH INST. ON FED. TAX 1067, 1075 (1959).

[51] Commissioner v. Gerstle, 95 F.2d 587 (9th Cir. 1938). See also Guaranty Employees Ass'n v. United States, 241 F.2d 565, 571 (5th Cir. 1957). *But see* Driscoll, *supra* note 50, at 1076.

[52] I.T. 3930, 1948-2 CUM. BULL. 126. Under Treas. Reg. 118, § 39.3797-4 (1953), "if an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association. . . ."

Essential Characteristics Under the Kintner Regulations

Since the business motive and associates are essential to all business enterprises, the absence of either of these characteristics is sufficient to negate association status.[53] These two factors will be emphasized to determine if a trust will be treated as an association for tax purposes; however, since associates and a business objective are common to a corporation and a partnership, the determination of its taxation as a partnership or association depends on the existence of centralization of management, continuity of life, free transferability of interests and limited liability.[54] The Regulations do not stipulate which of these four are essential nor how many must be present. An answer is possible from an analysis of the examples provided in the Regulations. Neither the limitation of liability [55] nor a provision for the continuity of life [56] is an essential element; however, if either of these characteristics are absent, all the others must be present to constitute an association. By necessary implication, centralization of management and at least a modified form of transferability of interest must be present. If any two characteristics are absent, this is in itself sufficient not to classify an association as a corporation.[57] The remaining examples offer no solution since all the factors are absent.[58]

This offers a mechanical approach to the solution but it makes more compact what has been diffused through case law since the *Morrissey* decision. The Regulations necessarily apply a flexible standard in adopting the resemblance test.[59] In this manner it is an embodiment of case law. In the last analysis, the purpose of referring to these characteristics is to establish a resemblance to a corporation. If too many of these corporate features are missing or are faintly present the resemblance will become too remote for the imposition of the corporate tax.

General Considerations of Taxability as a Corporation or Partnership

In organizing a business, the prime objective will be to maximize deductions to secure the greatest benefit for investors and to avoid

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[53] Proposed Regs. § 301.7701-2(a) (2).

[54] *Ibid.*

[55] Proposed Regs. § 301.7701-2(g), examples 1 and 5. These relate to medical and real estate associations.

[56] Proposed Regs. § 301.7701-2(g), example 6.

[57] Proposed Regs. § 301.7701-2(g), example 4. In example 4, the organization did not have the characteristics of continuity of life and limited liability but had centralization of management and a modified form of transferability of interests. The organization would be classed as a partnership and not as an association.

[58] See Proposed Regs. § 301.7701-2, example 2 (organization of doctors) and 3 (organization of attorneys) and example 7 (investment organization).

[59] See Proposed Regs. § 301.7701-2(a).

multiple layers of taxation.[60] A businessman conducting his business in a corporate form will find his profits subjected to the tax before it finds its way into his pocket. There is the tax on the corporate level and a tax to the individual when corporate dividends are distributed to the shareholders.[61] A partnership pays no income tax, the partners being liable in their individual capacities.[62] In the field of capital gains the shareholder foregoes the advantage of combining business capital transactions with his own, unlike the partnership.[63] Where a corporate business sustains capital losses with no offsetting capital gains, the loss could never be used as a deduction unless the business had offsetting capital gains in the five succeeding years.[64] The net operating loss sustained by the corporation can be used against income in preceding or succeeding years only by the entity and not by the shareholder.[65] The partner would take his share of the net operating loss.[66] To the business that invests heavily in stock, the corporate form is advisable since the corporation is allowed a deduction of an amount equal to 85% of dividends received from a domestic corporation.[67]

The prime factor for considering corporate status is to obtain the benefits of qualified pension, profit sharing and stock bonus plans under section 401. This is the area in which professional persons are at a disadvantage.[68] A general partner is not considered an employee of the partnership and consequently is unable to participate in section 401 benefits.[69] The *Kintner* case illustrates this fact. In order to qualify as an employee, Kintner contended that he was an employee of an association within the meaning of the predecessor of section 7701 in order to be an employee within the predecessor of section

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[60] See Driscoll, *The Association Problem in Joint Ventures and Limited Partnerships*, N.Y.U. 17TH INST. ON FED. TAX 1067 (1959).

[61] CODE §§ 11, 61. Payment of salaries offers an opportunity to transmit corporate profits to shareholders with only one tax. However, salaries to shareholders must be reasonable with regard to the services rendered. In addition, closely held family corporations will be scrutinized. See Korner, *Tax Factors In Doing Business As a Corporation*, 10 S.C.L.Q. 607, 615 (1958). Also on liquidation the net gains resulting therefrom are subject to the capital gains tax and when the proceeds are distributed to the stockholders in redemption of their stock, a capital gains tax will be paid to the extent they receive more than the cost basis of the stock. *Id.* at 621.

[62] CODE § 701.

[63] CODE § 702. Moore, *Should Your Business Be Taxed As A Corporation*, 33 TAXES 258, 260 (1955).

[64] Moore, note 63 *supra*.

[65] CODE § 172.

[66] CODE § 702. Korner, *supra* note 61, at 612.

[67] CODE § 243(a). This section does not include a small business investment company operating under the Small Business Investment Act of 1958, which is allowed a one hundred per cent deduction under § 243(b).

[68] Mackay, *Pension Plans and Associations Taxable as Corporations For Professional Persons*, 10 SW. L.J. 281 (1956).

[69] I.T. 3350, 1940-1 CUM. BULL. 64. See also Mackay, *supra* note 68.

401.[70] The tax consequences are favorable under a qualified pension plan. The employer contributions are deductible while the employee is not currently taxed on any amount contributed by the employer. The employee is taxed currently on the contributions he makes out of his salary. The earnings of the trust are not taxed.[71]

The Section 1361 "Corporation"

Section 1361 permits the unincorporated business enterprise, the partnership and the sole proprietorship the opportunity to elect to be taxed as a domestic corporation.[72] The question is whether such enterprise should take the election or, as an alternative, "plan" the organization to meet the requirements of section 7701 as outlined in the Kintner Regulations. The election will not save taxes for an owner whose individual tax rate is lower than the corporate rate.[73] Generally, there must be some undistributed profits if the election is to save any taxes [74] since the election is most favorable to a non-corporate business that has sudden large profits at the close of the taxable year.[75] In most cases the election will save taxes only for owners in the high income brackets.[76] The limitations of the section 1361 "corporation" highlight the importance of qualifying as a Kintner association. The business enterprise must be one in which capital is a material income producing factor or unless 50% of the gross income consists of gains, profits or income from trading or buying and selling real property or stocks for the account of others.[77] Partnerships and unincorporated businesses engaged in rendering professional services as law, accounting, engineering will not be classified as an enterprise in which capital is a material income producing factor.[78] Also, "a partner or proprietor of an unincorporated business enterprise as to which an election has been made . . . shall not be considered an employee for purposes of section 401(a) (relating

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[70] United States v. Kintner, 216 F.2d 418 (9th Cir. 1954). See CODE § 401. "A trust created or organized in the United States and forming part of a stock bonus, pension, or profit sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section." *Ibid.*

[71] SURREY & WARREN, FEDERAL INCOME TAXATION 505 (1955 ed.).

[72] CODE § 1361(a).

[73] McNaughten, *To Be Taxed As A Corporation*, 33 TAXES 253, 257 (1955).

[74] *Ibid.*

[75] See SURREY & WARREN, *supra* note 71, at 1237.

[76] McNaughten, note 73 *supra*.

[77] CODE § 1361.

[78] Treas. Reg. § 1.1361-2(e)(2) (1959). Such an enterprise cannot have more than fifty individual members. CODE § 1361(b)(1). No proprietor who has more than a 10% interest in the profits of such enterprise can be a partner or proprietor in another unincorporated enterprise taxable as a domestic corporation. CODE § 1361(b)(2).

to employees' pension trusts, etc.)";[79] nevertheless, the electing enterprise will be subject to most of the corporate provisions[80] including the accumulated earnings tax.[81]

Brief mention must be made of Subchapter S permitting certain small business corporations an election as to taxable status.[82] The electing corporation will not be subject to the tax on the corporate level but only on the stockholder level.[83] Under the regulations to Subchapter S the term domestic corporation means "a corporation as defined in section 7701(a)(3). . . ."[84] Although certain qualifications must be met for the election, it is possible that an association finding itself taxed as a corporation under section 7701, can make the election as to its taxable status. It is interesting to speculate what the Commissioner's position will be on such an election to avoid the section 7701 consequences.

Resulting Considerations

An interplay of sections 1361, Subchapter S and 7701 can produce varied tax results. It must be stated that in most situations if a taxpayer desired to be taxed as a corporation, he would form one. The problems arise wherein an enterprise, while intending to be either an association or a partnership, finds itself taxed as a corporation. Also, since section 1361 is sparsely used, it is possible that the taxpayer guided by the Kintner Regulations can "arrange" his association or partnership to qualify under section 7701 when he desires corporate status. The primary purpose would be to obtain section 401 benefits. Such taxpayer would not be hampered by an irrevocable election if he should desire to return to a partnership status.

Conclusion

The Kintner Regulations will be of special interest to law firms and professional associations, for by following the examples in the Regulations and the factors enumerated, they will be permitted to provide for retirement of their members by the establishment of pension funds. The Regulations present a more concise, compact and definite stand on these associations than had been disseminated through case law. The result will be a broadening of in-

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79 CODE § 1361(d).
80 CODE § 1361(c).
81 CODE § 1361(h)(2).
82 CODE §§ 1371-1377.
83 Treas. Reg. § 1.1372-1 (1959).
84 Treas. Reg. 1.1371-1(b) (1959). The term does not include an unincorporated business enterprise electing to be taxed as a domestic corporation. *Ibid.*

cludible associations within the corporate framework. On the other hand, it may be questioned whether it is common for such associations to possess some of these characteristics, particularly transferability of interest. The Regulations still leave unanswered what elements are required for inclusion, although the tests outlined above offer a solution.[85] The Regulations offer no answer to the "juggling" problem and the interplay of other sections of the Code. Although these problems will ultimately fall into the hands of the courts, the proposed Kintner Regulations should be adopted.

[85] The American Medical Association has recently objected to the language in the proposed regulations which deal with the effect of local law. It maintains that the new regulations are not likely to obtain the objectives desired in clarifying the distinction between partnerships and associations. CCH 1960 STAND. FED. TAX. REP. ¶ 8770.