WHAT’S UP, DOC?
TEXAS PROFESSIONAL ASSOCIATIONS
A BRIEF EXAMINATION

By:
Brian E. Walters

Walters Dunn
1101 Navasota St.
Suite 1
Austin, TX 78702
www.WaltersDunn.com
Phone: 512-236-1114
Fax: 512-236-1292
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I. INTRODUCTION

Texas professional associations are unique business entities. Their ownership is highly restricted, their operation is based on Texas corporate law, but they are not “corporations,” and while they may issue shares of stock, the people who hold those shares are called “members” rather than “shareholders.” In summary, they are confusing. Professional associations can confuse both the professionals forming the entity and the attorneys in charge of their organization, particularly if those attorneys lack experience in dealing with professional entities. This article details the general characteristics of Texas professional associations, the rules regarding their ownership and management, and describes their taxation on the state level.

II. GENERAL CHARACTERISTICS

A Professional Association is an association, as distinguished from either a partnership or a corporation, formed for the purpose of providing a professional service and governed as a professional entity under Title 7 of the Texas Business Organizations Code (the “BOC”).¹ Only the professionals listed below may provide services through a professional association:²

1. doctors of medicine;
2. doctors of osteopathy;
3. doctors of podiatry;
4. dentists;
5. chiropractors;
6. optometrists;

² Id.
(7) therapeutic optometrists;
(8) veterinarians; or 
(9) licensed mental health professionals.³

The list above is exclusive. No professionals other than those listed may provide professional service through a professional association.

A professional association, while analogous to a corporation, is specifically distinguished from a corporation by the BOC.⁴ This distinction is due to the belief by the Texas Medical Association that “the inherent relationship between doctor and patient should not be practiced through a ‘pure’ corporation entity.”⁵ Texas legislators created the professional association as a means to allow doctors of medicine to form an association that would enjoy limited liability protection while not being a true corporation.

A. Owners.

A professional association is owned by its members.⁶ The members of a professional association are analogous to the shareholders of a corporation. This similarity often causes confusion because: (1) the units of ownership in a professional association are referred to as shares,⁷ naturally indicating that the holders of such units would be called “shareholders,” and (2) the owners of limited liability companies and professional limited liability companies are also referred to as members.⁸ This entity-specific and somewhat confusing terminology demonstrates the special attention required when forming professional associations.

An individual may be an owner of a professional association in Texas if that individual is licensed in Texas or another jurisdiction to provide the same professional service as is rendered

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³ Id.
⁴ Id. § 301.003(2).
⁵ Trail, Hospital Liability and the Staff Privilege Dilemma, 37 Baylor L. Rev. 325, 363 (1995).
⁶ Id. § 1.002(53)(E).
⁷ Id. § 1.002(80).
⁸ Id. § 1.002(53)(A).
by the professional association. In BOC terminology, each member is required to be both an “authorized person” and a “professional individual.” Pursuant to these definitions, business entities are not permitted to own interests in professional associations. This is an important distinguishing characteristic of the professional association, as the “individual-only” ownership restriction does not apply to professional corporations or professional limited liability companies.

If a member of a professional association fails to meet the definition of an authorized person under the BOC, that member must promptly relinquish his or her ownership interest in the professional association. Additionally, a person who succeeds to the ownership interest of a member must promptly relinquish the member’s financial interest in the professional association if successor fails to meet the definition of an authorized person. The professional association is required to purchase the ownership interest of the non-authorized person. In the event that there is only one member of the professional association and that member is required to relinquish his or her financial interest, the BOC permits that member to act as the managerial official or owner of the entity for the limited purposes of winding up the affairs of the

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9 TEX. BUS. ORGS. CODE ANN §§ 301.007 (“A person may be an owner of a professional entity or a governing person of a professional limited liability company only if that person is an authorized person.”); 301.004 (“For purposes of this title, a person is an authorized person with respect to: (1) a professional association if that person is a professional individual; and (2) a professional corporation or a professional limited liability company if the person is a professional individual or a professional organization.”); 301.003(5) (“‘Professional individual,’ with respect to a professional entity, means an individual who is licensed to provide in this state or another jurisdiction the same professional service as is rendered by that professional entity.”).

10 Id. § 301.006.

11 Id. § 301.003(5).

12 Id. § 301.003(5) (Defines a professional individual as an “Individual.”); 1.002(38) (Defines “Individual” as a natural person.).

13 Id. § 301.008(b).

14 Id. § 301.008(c).

15 Id. § 301.008(d).
professional association and selling the outstanding ownership interests and other assets of the entity.\textsuperscript{16}

**B. Governing Authority.**

Professional associations are governed either by:

- (1) a board of directors; or
- (2) an executive committee.\textsuperscript{17}

The members of these governing bodies are elected by the members of the PA.\textsuperscript{18} Each member of the association is entitled to cast one vote as provided by the certificate of formation.\textsuperscript{19} The BOC makes no functional or regulatory distinction between a professional association that is governed by a board of directors and one that is governed by an executive committee. The only difference is the name used to describe the governing authority.

The BOC restricts who may be a director or an executive committee member of a professional association. First, only a member of the professional association is eligible to serve as a director or executive committee member.\textsuperscript{20} Second, only an individual licensed to provide in Texas or another jurisdiction the same professional service as is rendered by the professional association may be elected as a director or executive committee member of a professional association.\textsuperscript{21} A managerial official who fails to meet these qualifications is required to promptly resign its position and employment with the professional association.\textsuperscript{22}

**C. Officers.**

\textsuperscript{16} Id. § 301.008(e).
\textsuperscript{17} Id. § 302.005(a).
\textsuperscript{18} Id. § 302.005(b).
\textsuperscript{19} Id. § 302.006.
\textsuperscript{20} Id. § 302.008(a).
\textsuperscript{21} Id. § 302.007(b).
\textsuperscript{22} Id. § 302.008.
The BOC requires that professional associations elect officers. Officers are elected by the governing authority of the professional association, whether a board of directors or an executive committee. As with the governing authority of the professional association, there are restrictions on who may be elected as an officer of a professional association. First, only a member of the association may be elected as an officer. Second, the president of a professional association must be a member of the board of directors or executive committee, as appropriate. Third, the BOC states that only an individual licensed in Texas or another jurisdiction to provide the same professional service as is rendered by the professional association may be an officer of the association. An officer who fails to meet these requirements is required to promptly resign from that person’s officer position and employment with the professional association.

D. Providing Professional Service.

A professional association may provide professional service in the State of Texas only through owners, managerial officials, employees, or agents, each of whom (1) is licensed to provide in Texas or another jurisdiction the same professional services as is rendered by the professional association; and (2) is licensed in the State of Texas to provide the same professional service provided by the professional association. The professional association is the only entity in the BOC with a statute explicitly stating that only owners, managerial officials, employees, or agents licensed in Texas to provide the same professional service as is provided by

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23 Id. § 302.007.
24 Id. § 302.007.
25 Id. § 302.008(a).
26 Id. § 302.008(c).
27 Id. § 301.007(b).
28 Id. § 302.008.
29 TEX. BUS’N ORG. CODE ANN. §301.006 (“A professional association or foreign professional association may provide professional service in this state only through owners, managerial officials, employees, or agents, each of whom: (1) is a professional individual; and (2) is licensed in this state to provide the same professional service provided by the entity.”).
the professional association may provide professional services in Texas through the professional association.\textsuperscript{30}

The requirement that the employees of a professional association provide the same professional services as are provided by the professional association would appear at first glance to cause problems for physicians because it would prohibit the employment of nurses by a professional association. This is due to the fact that nurses would be providing a professional service (nursing services) that could not be provided through a professional association providing physician services.\textsuperscript{31} Additionally, employment of nurses by a PA would violate the requirement that a professional association may only provide one type of professional service.\textsuperscript{32} Fortunately, the BOC carves out an exception for nurses and a few other typical office employees. It provides that Section 301.006 may not be construed to prohibit a professional entity from employing nurses or from employing individuals who do not, according to general custom and practice, ordinarily provide a professional service, including clerks, secretaries, bookkeepers, technicians, or assistants.\textsuperscript{33}

Paragraph 2 of Section 301.006(A) requires that each owner, managerial official, employee, or agent of the professional association be licensed in Texas to provide the same professional service as is provided by the professional association if that owner, managerial official, employee, or agent is providing professional services in Texas.\textsuperscript{34} As far as the BOC is concerned, therefore, an individual may be a member of a Texas professional association so long as that individual is licensed in another state to provide the same professional services as are provided by the professional association. A member who is not licensed to provide professional services in Texas, however, may not provide professional services in Texas through the professional association until that person becomes licensed in Texas to provide such professional services.

E. Joint Practice Among Certain Professionals.

\textsuperscript{30} See TEX. BUS’N ORG. CODE ANN. §301.006(a)(2).
\textsuperscript{31} Id. § 301.003(2) (nurses are not listed as professionals permitted to form a professional association).
\textsuperscript{32} Id. § 2.004.
\textsuperscript{33} Id. § 301.006(d) (“To the extent that this subsection conflicts with any other law, this subsection controls.”).
\textsuperscript{34} Id. § 301.006(A).
The BOC permits practitioners of certain professional services to jointly form a professional association to provide more than one type of professional service. There are, however, restrictions on the authority of practitioners who form a joint practice professional association. Doctors of medicine, doctors of osteopathy licensed by the Texas State Board of Medical Examiners, and persons licensed as podiatrists by the Texas State Board of Podiatric Medical Examiners may form a joint practice in the form of a professional association to perform services that fall within the scope of practice of those practitioners. Further, doctors of medicine, doctors of osteopathy licensed by the Texas State Board of Medical Examiners, and persons licensed as optometrists or therapeutic optometrists by the Texas Optometry Board may, subject to the provisions regulating those professionals, jointly form and operate a professional association to perform services that fall within the scope of practice of those practitioners. Only a physician, optometrist, or therapeutic optometrist, however, may have an ownership interest in a professional association formed by such practitioners. Additionally, professionals other than physicians engaged in related mental health fields such as psychology, clinical social work, licensed professional counseling, and licensed marriage and family therapy may form a professional association that is jointly owned by those practitioners to perform services that fall within the scope of practice of those practitioners. A diagram of which practitioners may form a joint practice professional association is attached hereto as Attachment “A.”

The BOC places restrictions on joint practices to protect the integrity of each practitioner’s right to make independent decisions regarding treatment of his or her patients, free from the influence of the other members of the professional association. The BOC requires that
when doctors of medicine, osteopathy, and podiatry, or doctors of medicine, osteopathy, and
optometry or therapeutic optometry, or mental health professionals form a joint practice
professional association, the authority of each practitioner is limited by the scope of practice of
that practitioner.\textsuperscript{39} No practitioner may exercise control over the other’s clinical authority
granted by their respective licenses, either through agreements, bylaws, directives, financial
incentives, or other arrangements that would assert control over treatment decisions made by the
practitioner.\textsuperscript{40}

\section*{F. Limitation of Liability.}

Title 7 of the BOC touches very lightly upon the subject of liability in relation to
professional entities. It states that a professional association is jointly and severally liable for an
error, omission, negligent or incompetent act, or malfeasance committed by a person who is an
owner, managerial official, employee, or agent of the entity.\textsuperscript{41} Additionally, a professional
association is jointly and severally liable for similar acts committed by a person who, while
providing a professional service for the professional association or during the course of the
person’s employment, commits the error, omission, negligent or incompetent act, or
malfeasance.\textsuperscript{42} Any owners, managerial officials, and employees or agents of a professional
association who did not commit the error, omission, negligent or incompetent act, or
malfeasance, however, are not subject to such liability.

Texas corporate law provides the basic rules governing the operation of Texas
professional associations. It should therefore logically follow that the fundamental
characteristics of the corporation should be the fundamental characteristics of the professional

\textsuperscript{39} Id. § 301.012(f).
\textsuperscript{40} Id.
\textsuperscript{41} Id. §301.010(a).
\textsuperscript{42} Id. §301.010(a).
association. The most fundamental of corporate characteristics is that shareholders are ordinarily protected from personal liability arising from the activities of the corporation.\footnote{Byron Egan, Choice of Entity After Margin Tax and Texas Business Organizations Code, 45 (June 11, 2008) citing Delany v. Fid. Lease Ltd., 517 S.W.2d 420, 423 (Tex. Civ. App. – El Paso 1974), aff’d in part and rev’d in part on other grounds, 256 S.W.2d 270, 272 (Tex. 1975).} This holds true for the professional association. Section 21.223 of the BOC, applicable to professional associations through Section 302.001, states that a holder of shares or any affiliate of such holder may not be held liable to the professional association or its obligees with respect to:

1. the shares, other than the obligation to pay to the professional association the full amount of consideration for which the shares were or are to be issued;

2. any contractual obligation of the professional association or any matter relating to or arising from the obligation on the basis that the holder is or was the alter ego of the professional association or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar legal theory; or

3. any obligation of the professional association on the basis of the failure of the professional association to observe any corporate formality, including the failure to:
   
   (A) comply with the BOC or the certificate of formation or the bylaws of the professional association; or

   (B) observe any requirement prescribed by the BOC or the certificate of formation or bylaws of the professional association for acts to be taken by the professional association or its directors or members.\footnote{TEX. BUS’N ORG. CODE ANN. § 21.223(a).}
These limitations on liability do not prevent or limit the liability of a member if the obligee demonstrates that the member caused the professional association to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the member.\(^45\)

Professional associations are unique business entities designed to provide specific professional services that for-profit corporations in Texas are prohibited from providing.\(^46\) While the shareholders of a for-profit corporation may or may not provide personal service to the corporation’s customers, members of a professional association typically personally provide professional service to the professional association’s clients/patients. This arrangement does not preempt the limitation on liability of the members provided in Section 21.223; however, the drafters of the BOC wanted to make clear that 21.223 did not limit a patient’s right to recover against a negligent professional. The BOC, therefore, specifically provides that Title 7 does not affect in any way a person’s legal remedies against another person who commits an error, omission, negligent or incompetent act, or malfeasance while providing a professional service.\(^47\) Thus, a negligent professional, regardless of whether that professional is a member of a professional association, will still be personally liable for any errors, omissions, negligent or incompetent acts, or malfeasances committed while providing professional services.

III. **State-Level Taxation**

\(^{45}\) Id. §§ 21.223(b); 303.001.
\(^{46}\) **Tex. Occ. Code Ann.** §165.156 (Vernon 2008) (“A person, partnership, trust, association, or corporation commits an offense if the person, partnership, trust, association, or corporation, through the use of any letters, words, or terms affixed on stationary or on advertisements, or in any other manner, indicates that the person, partnership, trust, association, or corporation is entitled to practice medicine if the person, partnership, trust, association, or corporation is not licensed to do so.”).
\(^{47}\) TBOC § 301.001(b)(2).
The Texas franchise tax, sometimes referred to as the “margin tax,” is imposed on entities that enjoy limited liability protection under Texas law.\(^{48}\) A professional association is classified as a “taxable entity” and is therefore subject to the Texas Franchise Tax.\(^{49}\)

The franchise tax imposes a one percent (1%) tax upon a taxable entity’s “taxable margin” (or 0.5% of an entity’s taxable margin if such entity is primarily engaged in wholesale trade).

\(^{48}\)\textsc{Tex. Tax Code Ann.} §171.001 (Vernon 2008).

\(^{49}\)\textsc{Tex. Tax Code Ann.} § 171.0002 (Vernon 2008) (“DEFINITION OF TAXABLE ENTITY.”

(a) Except as otherwise provided by this section, “taxable entity” means a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, holding company, or other legal entity. The term includes a combined group. A joint venture does not include joint operating or co-ownership arrangements meeting the requirements of Treasury Regulation Section 2.761-2(a)(3) that elect out of federal partnership treatment as provided by Section 761(a), Internal Revenue Code.

(b) “Taxable entity” does not include:
   1) a sole proprietorship;
   2) a general partnership:
      A. the direct ownership of which is entirely composed of natural persons; and
      B. the liability of which is not limited under a statute of this state or another state, including by registration as a limited liability partnership;
   3) a passive entity as defined by Section 171.0003; or
   4) an entity that is exempt from taxation under Subchapter B.

(c) “Taxable entity” does not include an entity that is:
   1) a grantor trust as defined by sections 671 and 7701(a)(30)(E), Internal Revenue Code, all of the grantors and beneficiaries of which are natural persons or charitable entities defined in Section 501(c)(3), Internal Revenue Code, excluding a trust taxable as a business entity pursuant to Treasury Regulation Section 301.7701-4(b).
   2) an estate of a natural person defined by Section 7701(a)(30)(D), Internal Revenue Code, excluding an estate taxable as a business entity pursuant to Treasury Regulation Section 301.7701-4(b);
   3) an escrow;
   4) a real estate investment trust (REIT) as defined by section 856, Internal Revenue Code, and its “qualified REIT subsidiary” entities as defined by Section 856(i)(2), Internal Revenue Code, provided that
      A. a REIT with any amount of its assets in direct holdings of real estate, other than real estate it occupies for business purposes, as opposed to holding interest in limited partnerships or other entities that directly hold the real estate, is a taxable entity; and
      B. a limited partnership or other entity that directly holds the real estate as described in Paragraph (A) is not exempt under this subdivision, without regard to whether a REIT holds an interest in it;
   5) a real estate mortgage investment conduit (REMIC), as defined by Section 860D, Internal Revenue Code;
   6) a nonprofit self-insurance trust created under Chapter 2212, Insurance Code, or a predecessor statute;
   7) a trust qualified under Section 401(a), Internal Revenue Code; or
   8) a trust or other entity that is exempt under Section 501(c)(9), Internal Revenue Code.

(d) An entity that can file as a sole proprietorship for federal tax purposes is not a sole proprietorship for purposes of Subsection (b)(1) and is not exempt under that subsection if the entity is formed in a manner under the statutes of this state, another state, or a foreign country that limit the liability of the entity.)
or retail).\textsuperscript{50} Certain statutorily defined “passive entities” are not subject to the franchise tax; however, as a professional entity will always fail to meet such definition, the subject will not be expanded upon here.\textsuperscript{51} The following is a short example of how a taxable entity’s franchise tax may be calculated at the time this paper is being written:

\textsuperscript{50} \textit{Tex. Tax Code Ann.} § 171.002(a).

\textsuperscript{51} Id. § 171.0003.
<table>
<thead>
<tr>
<th>Begin with:</th>
<th><strong>Total Revenue from Entire Business</strong>&lt;sup&gt;52&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less:</td>
<td>The greater of:</td>
</tr>
<tr>
<td></td>
<td>1. “Cost of Goods Sold,” or</td>
</tr>
<tr>
<td></td>
<td>2. “Compensation” (with certain limits)</td>
</tr>
<tr>
<td>Equals:</td>
<td><strong>Margin (not to exceed 70% of total revenue)</strong></td>
</tr>
<tr>
<td>Multiplied by:</td>
<td>Texas apportionment percentage calculated under TEX. TAX. CODE § 171.106</td>
</tr>
<tr>
<td>Equals:</td>
<td><strong>Apportioned Margin</strong></td>
</tr>
<tr>
<td>Less:</td>
<td>Other allowable deductions (see TEX. TAX. CODE § 171.101(a)(3))</td>
</tr>
<tr>
<td>Equals:</td>
<td><strong>Taxable Margin</strong></td>
</tr>
<tr>
<td>Multiplied by:</td>
<td>Tax Rate, generally 1% (0.5% for wholesalers and retailers)</td>
</tr>
<tr>
<td>Equals:</td>
<td><strong>Total Tax Liability</strong></td>
</tr>
<tr>
<td>Less:</td>
<td>Allowable Tax Credits</td>
</tr>
<tr>
<td>Equals:</td>
<td><strong>Tax Due</strong></td>
</tr>
</tbody>
</table>

Up until the legislative session in 2009, there was a $300,000.00 total revenues floor that had to be met in order for a taxable entity to be subject to the franchise tax.<sup>54</sup> H.B. 4765, which is effective September 1, 2009, amended the Texas Tax Code to increase raise this floor to $1,000,000.00.<sup>55</sup> This increase began in 2010. It should be noted that while the pre-H.B. 7465 Texas Tax Code contained a phase-in of the application of the franchise tax, the new legislation has an all-or-nothing application. In other words, if an entity crosses the one million dollar mark, the franchise tax will be applied but if the entity has any amount less than one million dollars, the franchise tax will not be applicable.

**IV. CONCLUSION**

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<sup>52</sup> TEX. TAX CODE ANN. § 171.1011(c)(1)(A) (defines “Total Revenue from Entire Business” as the total amount of income from a corporation’s IRS Form 1120 lines 1c and lines 4-10).


<sup>54</sup> TEX. TAX CODE ANN. § 171.002(d).

<sup>55</sup> H.B. 4765 (2009).
The professional association continues to be the most popular entity choice for physicians in Texas. This preference likely due to the professionals’ familiarity with the entity form, the duration of time it existed prior to the professional limited liability company, and the inapplicability of the franchise tax to this entity prior to its revision. and to the fact that it is the entity with which Texas physicians are most familiar. Nevertheless, other entity choices exist that should be examined because they may provide benefits unavailable in a professional association.
**ATTACHMENT A**
**PROFESSIONAL ASSOCIATION JOINT PRACTICES**

<table>
<thead>
<tr>
<th>PROFESSIONAL ASSOCIATION</th>
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<tbody>
<tr>
<td>Doctors of Medicine</td>
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<tr>
<td>Doctors of Osteopathy</td>
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<tr>
<td>and</td>
</tr>
<tr>
<td>Licensed Podiatrists(^{56})</td>
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<td></td>
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<tr>
<td>Doctors of Medicine</td>
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<tr>
<td>and</td>
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<tr>
<td>Licensed Doctors of Osteopathy</td>
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<tr>
<td>and</td>
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<tr>
<td>Licensed Optometrists or Therapeutic Optometrists(^{57})</td>
</tr>
</tbody>
</table>

Professionals, other than physicians, engaged in related mental health fields such as psychology, clinical social work, licensed professional counseling, and licensed marriage and family therapy.\(^{58}\)

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\(^{57}\) Id. § 301.012(c).

\(^{58}\) Id. § 301.012(b).