

JOINT INFORMATIONAL HEARING

Regulation of Corporations and the Impact on Professional Licensing

Assembly Committee on Business and Professions Senate Committee on Business, Professions and Economic Development

**March 14, 2017
State Capitol, Room 4202
9:30 a.m. to 11:30 a.m.**

Background Paper

This background paper is intended to provide a brief overview of the history and development of the Moscone-Knox Professional Corporation Act (Act), which led to the formation of professional corporations in California, and to review the regulatory structure of corporate professional service providers in California. The goal of this hearing is to examine whether the current regulatory structure for professional corporations is sufficient or if any changes are warranted to ensure sufficient protection of consumers and the public.

Professional Licensing

Occupational or professional licensing is a form of regulation that requires individuals who seek to engage in certain types of work to obtain the permission of the government.¹ In California, many of the professions that require professional licenses are regulated by boards within the jurisdiction of the Department of Consumer Affairs (DCA), whose main charge is the protection of the public. Through statute, regulatory boards, bureaus, and committees, operating under the jurisdiction of the DCA, are required to establish the regulatory framework for licensing, education and enforcement. Today, DCA licensing entities issue more than 2.8 million licenses, certificates, and approvals to individuals and businesses in 250 categories.

California's commitment to protecting consumers through licensing began with the passage of the Medical Practice Act of 1876. The Medical Practice Act was designed to regulate the State's medical professionals, who had operated virtually unchecked. Additional professions and vocations were brought under State authority over the following 30 years. By the late 1920s, the Department of Vocational and Professional Standards was responsible for licensing or certifying accountants, architects, barbers, cosmetologists, dentists, embalmers, optometrists, pharmacists, physicians, and veterinarians. The Consumer Affairs Act was passed in 1970, creating the agency now referred to as the DCA.²

¹ Occupational Licensing: A Framework for Policymakers, July 2015. Retrieved from https://obamawhitehouse.archives.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf

² http://www.dca.ca.gov/publications/dca_booklet.pdf

As noted in a 2015 article released by the federal Bureau of Labor Statistics, "occupational licensing directly affects nearly 30 percent of U.S. workers today and continues to grow in density and scope."³ Notably, education, examination, and other requirements for licensure vary across the nation, with some states requiring licensure for certain professions while others merely require voluntary certification or simple registration.

The strength of the system for professional licensure is reliable oversight of professions by regulatory agencies, which in turn directly impacts consumer protection. Given that a professional license can be suspended, revoked, or otherwise disciplined when a licensee violates a practice act, a deterrent factor is inherent, as it is presumed that a licensee will not act in a capacity that would lead to the discipline of a license, which could in turn disrupt an individual's ability to practice the profession.

Prior to 1968, the common practice in California was that professional services could be provided only pursuant to a license and could not be rendered by a professional business organized as a corporation in California. Discussions began in the early 1960's to allow the formation of professional corporations, for a limited number of regulated professions, in order to provide those individuals with some of the same benefits that general corporations received including, tax benefits, health plan benefits, and reduction of personal liability exposure. However, a major underlying concern for the proponents of continuing the prohibition against the corporate practice of licensed professions was that lay shareholders and directors may not be bound by the same ethical standards that professional licensees are and instead may focus on financial gains rather than consumer protection and professional standards.

Professional Corporations

A professional corporation is an organization made up of individuals of the same trade or profession. In 1968, the California Legislature enacted the Act which established the requirements for the practice of professional services in corporate form. When the Act was passed in 1968, some personal service professions already had the legal authority to form corporations. Physicians, attorneys and dentists were not included, and were authorized to establish professional corporations at that time. By 1973, the Act had extended corporate practice to chiropractors, physical therapists, psychologists, optometrists, accountants, and shorthand reporters. However, as noted in historical information provided by the California Research Bureau, at the time of the Act, the Department of Finance opposed the legislation, because other professions would want similar authorization, as the Act provided an economic benefit that "allows physicians, lawyers, and dentists to reduce their taxes in a manner that self-employed persons and wage-earners cannot."

There are currently 16 authorized healing arts professional corporations. Current law specifies which healing arts licensees may be shareholders, officers, directors or professional employees of professional corporations controlled, including by a differing profession so long as the sum of all shares owned by those licensed persons does not exceed 49 percent of the total number of shares of the professional corporation. Corporations Code Section 13401.5 authorizes the formation of various healing arts professional corporations and establishes which healing arts

³Retrieved from <https://www.bls.gov/opub/mlr/2015/article/the-de-licensing-of-occupations-in-the-united-states.htm>

licensees who are not of the same license type as the corporation may be shareholders, officers, and directors of that corporation. Any person licensed under the Business and Professions Code (BPC), the Chiropractic Act, or the Osteopathic Act may be employed by these professional corporations. Thus, the services of professional corporations are not limited to the named profession. For example, a nursing corporation may have a director who is a chiropractor, a shareholder who is an acupuncturist, and employ an accountant, podiatrist, and a marriage and family therapist, none of which would traditionally be seen as providing the professional services of nursing. Current law authorizes a medical corporation to have a number of health licensees as officers, directors, and shareholders.

In a report from the California Research Bureau, it reported that as a result of additions to the Act, license holders in a variety of other health professions can also serve as shareholders, officers, directors, or employees of professional medical corporations. "These include: podiatrists, psychologists, nurses, optometrists, marriage and family counselors, clinical social workers, physician assistants, chiropractors, acupuncturists, naturopathic doctors, professional clinical counselors and physical therapists. Corporations Code, Section 13400-13410 specifies that physicians and surgeons can also serve in these capacities in other professional healthcare corporations, including corporations of the following types: podiatric, psychological, nursing, marriage and family therapist, clinical social worker, physician assistants, optometric, chiropractic, acupuncture, naturopathic doctors, dental, professional clinical counselor and physical therapy. While California enacted most of these exemptions between 1970 and 1980, the most recent change came in 2013 when physical therapy professional corporations were created and physical therapists were granted the explicit authority to serve as shareholders, officers, director or professional employees of professional medical corporations."⁴

Provisions of the Act requiring corporations to be owned by licensees are reflected in the various practice acts within the BPC that govern the licensure and regulation of a number of professions. For example, BPC Section 8040 specifies that "a shorthand reporting corporation is a corporation which is authorized to render professional services... as long as that corporation and all of its shareholders, officers, directors, and employees rendering professional services who are certified shorthand reporters are in compliance with the Act." BPC Section 4150(a) states that "A pharmacy corporation means a corporation that is authorized to render professional services, as defined in Section 13401 of the Corporations Code, so long as that corporation and its shareholders, officers, directors, and employees rendering professional services who are pharmacists are in compliance with the Act."

In at least two professions, corporate ownership is permitted by an authorized license issued by the regulatory agency, without requiring the owner to be a licensee. BPC Section 7065(b)(3) specifies that a "corporation may qualify by examination for a contractor's license upon the appearance of a qualifying individual appearing either as a responsible managing officer or a responsible managing employee on behalf of the corporation." Currently, the Contractors State License Board has jurisdiction over 76,000 corporate licensees. In addition, the California Board of Accountancy, per BPC Section 5079, permits any firm lawfully engaged in the practice of public accountancy in California to have owners who are not licensed as certified public

⁴ California Research Bureau. *The Corporate Practice of Medicine in a Changing Healthcare Environment*. April 2016. Retrieved from <http://www.library.ca.gov/crb/CRBReports.html>

accountants. These examples contrast with other requirements in the Act which specify a licensed individual to be a corporate owner. As of January, 2015, the California Board of Accountancy licenses about 5,556 accountancy firms (both Partnerships (1,468) and Corporations (4,088)) and currently registers 294 out-of-state accounting firms.

PURPOSE OF THE HEARING

This hearing provides the Committees and the Legislature with a unique opportunity to review a decades-old law and determine whether the law works as intended, works consistently across the regulatory landscape, or necessitates changes to ensure optimal oversight for licensees and professional corporations.