

PLANNING FOR PHYSICIANS

SELECTING THE PROPER BUSINESS ENTITY

- a. Choosing the best form requires consideration of three important factors:
 1. Liability insulation
 2. Tax treatment
 3. Convenience of formation and administration
- b. The ideal entity would shield the professional personally from practice liability, be nontaxable and be free of requirements, restrictions and limitations in co-ownership arrangements, formation and administration
- c. Unfortunately, this is an imperfect world, and no one business entity is best in all circumstances

The Sole Proprietorship

- a. No insulation from liability
- b. The proprietor is personally liable for all of the obligations of the business
- c. Both business and personal assets are available to satisfy creditors of the business OR of the sole proprietor
- d. Proprietors must file estimated income tax returns; pay self-employment taxes and pay withholding and Social Security taxes for employees

The General Partnership

- a. Is considered to be a legal entity distinct from its partners

- b. Partners are liable for all debts and obligations of the partnership
- c. A professional who is a partner of a general partnership is liable for his own professional errors and omissions and those of his partners and/or associates
- d. Under Subchapter K, the partners pay income taxes based on their share of the profits
- e. The partnership must file its own tax return
- f. Partners must file estimated income tax returns; pay self-employment taxes and pay withholding and Social Security taxes for partnership employees
- g. Can chose to be taxed as a partnership or as a corporation

The Registered Limited Liability Partnership

- a. Limited liability partners enjoy "full-shield" liability protection
- b. This does not relieve a partner from liability arising from that partner's acts or omissions in his or her individual capacity, but only from liability arising "solely by reason of his partner status"
- c. Partners are not liable for all debts and obligations of the partnership
- d. This protection is appealing to professional practices
- e. Can chose to be taxed as a partnership or as a corporation

The Professional Limited Liability Company

- a. A professional member will not be liable for debts or claims against the professional limited liability company, or for the acts or omissions of the professional limited liability company or any other member or employee

- b. Only the assets of a limited liability company itself are subject to the claims of creditors
- c. Can chose to be taxed as a partnership or as a corporation
- d. May be member or manager managed
- e. Duration is perpetual
- f. Single member limited liability companies are allowed under Virginia law - provides the dual advantages of insulation from liability and elimination of income tax at the business entity level
- g. There are no formalities that must be observed to preserve the limited liability of the members

The Professional Corporation

- a. Shareholder-employees are not personally protected from their own acts of malpractice; however, they are protected from the general debts and obligations of their practice as well as from the acts and omissions of their fellow employees
- b. As a result, incorporation of a professional practice does not affect the liability that a professional would have for his or her own malpractice
- c. Nevertheless, incorporating a professional practice may protect a professional's personal non-exempt assets for malpractice committed by another professional in the same corporation and may also limit the professional's personal liability with respect to ordinary business debts and non-malpractice torts (Section 13.1-547)
- d. Double taxation of earnings - at the corporate level and at the personal (owner/employee) level; can avoid this result by distributing substantial salaries to the owners who are also employees

- e. If a corporation is used, it may be either a "C" or an "S" corporation. A regular corporation will be classified as a "personal service" corporation and, therefore, will not be eligible for graduated corporate tax rates and is taxed at a flat 35% federal rate based upon its taxable income
- f. Physicians with large compensation frequently elect Subchapter S tax status so they can pay and make retirement distributions without being subject to Medicare tax; in addition they do not have concerns about unreasonable accumulations or compensation unlike shareholder/employees of a C corporation; further, interest paid on loans used to buy a practice is deductible business interest; finally, S corporations are not subject to the alternate minimum tax on life insurance and other preference items
- g. CPAs like S corporations to avoid payroll/Social Security and Medicare taxes - BUT the IRS will penalize S corporation shareholders who don't pay themselves a sufficiently high salary to avoid paying such taxes
- h. There are statutorily mandated meeting and record keeping formalities that must be observed
- i. NEVER put real estate into a corporation or other professional business entity - otherwise it is subject to creditor's claims

Qualified Retirement Plans

See attached.

Physician Employment Agreements

Every medical group should have an employment agreement in place for each physician.

Although the emphasis is on group practices, even an incorporated single physician should have an executed agreement as part of the corporate records.

Compensation

- a. For example, is payment based on production or a straight salary
- b. What about **incentive bonuses**? Good for new physicians - typically a percentage of the collections on the new physician's production when the collections exceed a certain level (typically, the level is two to two and a half times the physician's total compensation package)
- c. **Death, Disability or Termination of Employment**
 1. The employment agreement must make clear the amount of compensation that is owed in the event of a physician's death, disability or termination of employment
 2. Failure to provide for these events could cause the physicians and their families severe financial hardship
 3. Most contracts provide that if a physician leaves the practice, he or she is entitled to accrued compensation, earned but unpaid bonuses and accrued vacation pay
 4. It is VERY IMPORTANT to address how much and for how long a physician will be paid in the event of his or her **disability**, whether permanent or temporary - the physician or the practice should have a disability insurance policy
 5. In the event of disability, the employment contract may provide for additional compensation to the able-bodied physician
 6. For small medical practices, consider an overhead disability policy
 7. **Deferred Compensation** - the employment contract should have a provision dealing with deferred compensation; this would apply only if the practice is going to pay the physician his or her share of the practice's accounts

receivable when the physician leaves (it also ensures the deductibility of payments to a departing owner)

- a. Payable upon death
- b. Payable upon disability
- c. For termination without cause
- d. For termination with cause
- e. All other termination events

NOTE: Section 409 A impacts on deferred compensation plans; it is very important to take into account that complex law's effect upon income inclusion or non-inclusion at the time of the deferral; penalties and interest in the event the plan does not meet the Section 409 A requirements

d. Compensation Formulas

1. Equal Compensation - simple, fosters teamwork; does not reward productivity
 2. Production with Fixed, Variable and Direct Costing - based on each physician's production with overhead allocated to each physician on an agreed-upon formula
 3. There are a variety of other compensation formulas to discuss and consider, and may include formulas designed specifically for transitional models as capitation grows
- e. **Partial Retirement of a Physician** - consider a reduced salary that is reviewed periodically; or the practice may want to purchase the physician's interest by means of a buy-sell agreement
- f. **Fringe Benefits** - a physician's employment agreement should explain exactly which fringe benefits the practice will pay for on behalf of the physician-employee:

1. Retirement plan
 2. Health insurance
 3. Disability insurance
 4. Annual medical licensure
 5. Reimbursement of board certification expenses
 6. Malpractice insurance premiums
 7. Dues and publications
 8. Continuing medical education
 9. Vacation leave and sick leave
- g. **Practice Buy-In** - consider (1) what percentage of the practice will be purchased by the new owner and when will it effective; (2) how will such interest be valued; and (3) how will the purchase price be paid
- h. Covenants not to compete and nonsolicitation clauses
- i. **EACH PHYSICIAN IN A GROUP PRACTICE SHOULD SIGN AN EMPLOYMENT AGREEMENT. THOSE WITHOUT CONTRACTS EXPOSE THEMSELVES TO LITIGATION**
- j. A perfect compensation plan would address the practice's goals and missions; it would encourage:
1. Maximum net income generation
 2. Minimum overhead
 3. Efficient practice
 4. Quality medical care and services
 5. Fair distribution of income
 6. Harmony

Practice Sales and Purchases and Buy-Sell Agreements

- a. Any medical practice with more than one physician-owner needs a buy-sell agreement - the agreement explains the manner in which an owner can buy into the practice and how the practice will buy out an owner

- b. Corporations have buy-sell agreements, which sometimes are called "shareholder agreements"
- c. Partnerships generally have similar provisions incorporated into their partnership agreements
- d. The buy-sell provisions should be reviewed periodically due to health care reform, the continued attacks on service reimbursements, Medicare cuts, and the adoption of resource-based relative value payment system by other payors - these items affect and change the value of the physicians' ownership interests
- e. The buy-sell agreement fixes a departing physician's interest either by appraisal or by some type of fixed formula approach
- f. **FAILURE TO HAVE A BUY-SELL AGREEMENT IN PLACE MAY LEAD TO LITIGATION DUE TO THE PARTIES' DIFFERENT OPINIONS AS TO THE VALUE OF THE PRACTICE**
- g. The buy-sell agreement should address covenants not to compete
- h. The remaining physician owners will need to maintain the tax deductibility of the buy-out payments
- i. The physicians should never assume that buy-out payments are deductible - it is therefore critical to properly structure the buy-out payments
- j. Other provisions in buy-sell agreements:
 - 1. Involuntary removal
 - 2. Temporary disability
 - 3. Adding a new owner
 - 4. Sale of the practice

Estate and Business Practice Planning

Asset Protection Planning

- a. Preserving your estate on death - reduce estate taxes and avoiding probate costs and delays
- b. Preserving your assets during your lifetime
- c. The medical practice entity generally will not and should not own anything that is not necessary to effectuate the operations of the medical practice
- d. Nonessential assets (such as real estate) should be held in a separate entity and then leased by means of an asset protection lease to the practice
- e. Practices owning valuable equipment and furniture might consider a sale of such assets to an irrevocable trust for family members or a family limited partnership which would primarily benefit children or other low income tax bracket relatives of the physician
- f. Many medical practices wish to provide deferred compensation plans for physicians where life insurance and annuities are protected from creditor's claims

Types of Liability

- a. Malpractice liability
- b. Business and personal transactions
- c. Medicare and insurance repayment liability (inappropriate billing)
- d. Practice management company debacles

Business Entity

- a. Sole proprietorship - potential personal liability for acts committed by practice employees, typical business liabilities, etc.
- b. General partnership - joint and several liability and the unlimited liability for one partner for the

torts, business debts and similar obligations of the partnership

- c. C corporation - under current tax law, earnings must be taken out as wages to avoid the corporate tax, thereby subjecting all earnings to FICA/FUTA and the 2.9% combined Medicare tax; upon sale of practice, corporate level tax may occur
- d. S corporation - earnings can to some extent be characterized as dividends which are not subject to the 2.9% Medicare tax; upon sale of practice, no double taxation; unreasonable compensation is seldom an issue from a deductibility standpoint
- e. Limited Liability Companies - are a popular entity for medical practices; if owned by only one physician, the LLC need not file a tax return; the flow through of tax attributes from the members/owners can be more flexible than under the S corporation tax rules
- f. **High earning physicians** will prefer S corporations over Limited Liability Companies, with the exception of the Limited Liability Companies that elect to be taxed as S corporations - this allows preservation of pass-through treatment for income tax purposes while receiving the advantageous treatment afforded S corporations under the self-employment tax rules
- g. **Insurance** - not just malpractice

Retirement Plans

- a. It is strongly recommended that employers engage a pension administration company to assist in the implementation of all retirement plans, including SEP-IRAs and SIMPLE plans

Estate Planning

Mistake Number 1 - failure to seek an estate planning specialist; law, just as medicine, has become very specialized

Mistake Number 2 - hiring the cheapest estate planning

attorney - "It is unwise to pay too much, but it is worse to pay too little. When you pay too much, you lose a little money - that is all. But when you pay too little, you stand to lose everything because the thing you bought was incapable of doing the thing it was bought to do.

Mistake Number 3 - Believing that estate planning can be done with generic documents. Your estate plan should be custom built to meet your needs

Mistake Number 4 - Failure to include your spouse or other trusted family member or friend's input in the estate plan design and creation

Mistake Number 5 - Failure to include all your advisors in the estate plan process - typically, the CPA and financial advisor should participate in the estate plan design process

Mistake Number 6 - Failure to get a second opinion regarding your old estate planning - the plan must be kept up to date; rarely will an old plan not need some improving

- a. Make sure your patient files are maintained in the event of death, disability, impairment or incapacity within the rules of professional confidentiality and activity
- b. Name a physician agent under a durable power of attorney, a (co)-Executor and a (co)-Trustee to maintain your files; sell or liquidate your practice, make payments of current liabilities, collect accounts receivable, notify your professional liability carrier, notify your patients, notify all boards and administrative agencies, coordinate with your accountant and estate/business lawyer