

# Law for Medical Students and Physicians: Money, Taxes, and Fraud

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## I. Learning Objectives

At the end of the learning session, the student shall be able to:

- 1) Know generally what a corporation is
- 2) Know why a Limited Liability Company format is so popular
- 3) Have a simple knowledge of taxable income.
- 4) Be able to name three common fraudulent practices in the medical industry.

## II. Pre-lecture Questions: True or False?

- 1) Moving costs to your first job out of residency are tax deductible.
- 2) Textbooks for medical school are deductible
- 3) You may include the time it takes to write a note in the CPT code.
- 4) The original purpose for incorporation was asset protection; but the purpose for professionals to incorporate is to reduce taxes.
- 5) Partnerships do not provide liability limitation.
- 6) Limited partnerships may provide liability limitation.
- 7) Only a professional corporation or a physician may practice medicine in Ohio.
- 8) Estate planning is mostly about reducing taxes.

## III. Preamble

This lecture is different in format from the others, because there are almost no citations, and the lecture notes closely follow the slides. The reason for this departure is that this material -- business forms, taxation, and fraud -- should be understood completely, in outline form. If you have the contents of this briefest monograph in your mind, it will help you when you get into business as a doctor.

## IV. Business Forms

- 1) Sole proprietorship: This is the simplest way of doing business. It requires no license (except your medical license), but if you have a "dba" or "doing business as" name you may want to register it in the county in which you do most of your business. This protects the business name as your property, to some extent. An example of a sole proprietorship is a doctor who has a private practice, which is carried out in his own name, with no

formalities. In Ohio such a business is not required to carry medical malpractice insurance, although such practice would be unwise.

- 2) General Partnership: This is an agreement between two or more natural (alive) persons to carry on a business. Each partner is fully liable for the business debts of the whole partnership; and is liable even as to his personal assets such as his house, or car.
  - a. It is most customary for the agreement to be written; but it may be unwritten and still be valid and enforceable.
  - b. Also, where two or more people do business together and reasonably appear to be partners, they may be deemed a partnership by estoppel.

**Two friends rent an office together, each bills separately, but they refer back and forth to each other, and praise the abilities of the other to patients; and in fact, they have a common waiting room, and a common receptionist. Most patients refer to them as partners, and, although they are not, neither doctor discourages this notion. Doctor # 1 orders an expensive medical machine; and can't pay for it. The medical machine company sues doctor #1 and doctor # 2, as partners, to pay for the machine. Does # 2 have anything to worry about?**

- c. A partnership is automatically dissolved when any member leaves.
- 3) Business Corporation: A corporation is an artificial person; formed in accordance with a statute, and registered in Ohio with the secretary of state in Columbus. A person can sue or be sued; and so can an artificial person.
  - a. A corporation can live forever: there is nothing that ties it to a human life span.
  - b. It pays taxes at a lower rate than you or I; and it gets more deductions (approximate average rates 25-38%).
  - c. The ownership of the corporation is easily transferable to other persons.
  - d. The owners of a corporation hold shares in it; and cannot be sued for their personal assets to pay a corporate debt.
  - e. For Profit: a corporation organized to make money.
  - f. Not for Profit: a charitable corporation, which does not pay income tax, but which must have a charitable non-political purpose in return for not paying taxes.
    - i. The IRS is going after churches that campaign in politics, and also charitable hospitals that are really not charitable.
- 4) Professional Corporation: Back in the days of the dinosaurs, when I was a boy and a teen, the personal income tax rate was at 77% for the top bracket; but the corporate tax rate maximum bracket was 25%. Many professionals formed a special kind of corporation called a professional

- corporation (P.C.) to do their professional business; which employed them and paid them a salary, (taxable at the high individual rates) but also accrued value after income taxation at the lower rate. This also permitted the employee professional to get health insurance and other benefits which the corporation paid for, but which the professional did not pay tax on. This was made possible by a special law; and that law specifically stated that the corporation 1) could practice medicine and 2) must have malpractice insurance.
- a. These professional corporations still had to follow certain formalities of corporate law, which could prove cumbersome.
  - b. A non-professional could not have an ownership in the professional corporation (except for the widow or widower of a recently deceased professional).
  - c. Many personal service corporations are taxed at a flat 38% rate.
- 5) Limited Liability Company: As the difference between corporate and personal income tax rates decreased, in the 1990's; professionals and other business people looked for a more flexible form of business entity than the corporation or professional corporation.
- a. The first try was the limited partnership with a corporate general partner.
  - b. The limited liability company is now the most popular form for professionals in which to do business. This is a statutory creature with the following attributes:
    - i. Informal structure;
    - ii. Easily "alienable" (can sell or give shares);
    - iii. Limitation of liability for personal assets BUT NOT of malpractice liability;
    - iv. "Check the Box" taxation election. This means, you can be taxed as an individual or a corporation, just by checking a box. This election, however, cannot be lightly reversed.
- 6) Employee: More than half of all physicians receive some income from employment, either by corporations, or by professional corporations or other physicians. We shall discuss employment law in a separate lecture.
- 7) Closing the business.
- a. Sole Proprietorship: "Going out of business"
  - b. General Partnership: "winding up"
  - c. Corporation: "Dissolution".
    - i. Special rules for not-for-profit dissolution to prevent the flow of untaxed assets into private "for-profit" hands.
  - d. Limited Liability Company: "Dissolution".
  - e. Special Concerns: Capital Gains

- i. Lower tax rate (15% for non-collectibles)
- ii. Special rules (must hold assets for 12 months).
- iii. Watch out for alternative minimum tax.

## **V. Income and Estate Taxation**

- 1) Personal Income Taxes:
  - a. Income: ALL the cash!!!!
  - b. Deductions:
    - i. Mortgage Interest
    - ii. Bona Fide Business Expenses for an ongoing business.
      1. Cannot deduct education or preparation to enter a career.
    - iii. Health costs > 7.5% Adjusted Gross Income
    - iv. Catastrophic losses.
    - v. Alimony if court ordered
    - vi. Watch out for AMT
  - c. Credits:
    - i. Other taxes.
    - ii. A few piddling pork credits.
- 2) Corporate Income taxes:
  - a. Income:
    - i. Net accrued, realized and recognized income. (Many ways to vary "income").
    - ii. If loss, no tax, and carry-forward of loss.
    - iii. Maximum marginal rate is 38% but effective rates are lower.
  - b. Deductions:
    - i. Compensation of employees
    - ii. Health and Pension benefits within certain rules.
    - iii. Depreciation and depletion
    - iv. Maintenance
    - v. All interest
- 3) Estate and Gift Taxes.
  - a. Estate tax: sheltered up to 1.5 million
  - b. Gifts (lifetime) sheltered to 1.0 million
  - c. Tax of either above sheltered limits at 48% (before phase-out).
  - d. Gifts exclusion: \$11,000 per donee per year.

## **VI. Fraud in the Health Care Industry**

- 1) Self-referral ("Stark"). No requirement of "guilty mind" (mens rea).
  - a. Stark I: (Before 1995) Referral to labs in which referring physician has financial interest strictly forbidden.

- b. Stark II: (After 1995): Referrals for designated health services (reimbursable by Medicare) not permitted to entity in which physician or family member has a financial interest.
- c. Stark safe harbors: bona fide wages, purchase or sale agreements, office or equipment rental, and approximately 24 other specific exceptions.
- d. "The Stark law is implicated whenever a physician has a financial relationship of any kind with an entity to which the physician refers Medicare business." Chananie, Colangelo *et al.* "Chapter 36: Fraud and Abuse" in Abrams and Moy, *Legal Manual for New York Physicians* NYSBA 2003.

**What if a not-for-profit hospital corporation finances and supports the building and staffing of a for-profit ambulatory surgery and physician office building facility; and the for-profit uses the lab facilities of the not-for-profit entity. The for-profit is owned by the physicians acting in the practice; but many of these physicians are also on staff (and get money by that fact) at the not-for-profit hospital.**

2) Kickback and Fee-splitting:

- a. Kickback: A state crime requires knowing violation (*mens rea*) of the principle that offering any remuneration for a medical referral is unethical.
  - 1. Proof of *mens rea* beyond a reasonable doubt.
  - ii. Federal: 42 USC 1320a-7b (b): Offering a present ("remuneration") to someone in return for a Medicaid or Medicare billable service.
  - iii. State: Usually, both offeror and recipient of remuneration for any medical service are guilty of either misdemeanor or (depending on amount) felony in the course of medical practice. This of course could lead not only to criminal penalties, but to loss of medical licensure.
- b. Fee splitting: another state crime requiring *mens rea*.
  - i. You pay a portion of any fee you make to a non-physician.
    - 1. The most common example is an office rent which varies by the amount of business billed from the office.
    - 2. Sometimes, "overhead" fees may be fee-splitting.
    - 3. Also common is a kick-back split fee, where you get a monetary reward for referrals to another physician or non-physician.
      - a. This differs from kick-back only slightly.
  - ii. Group practices and partnerships, including academic partnerships, that pool or share fees are usually exempted.

**What if a graduate of a medical school, who however has not done a residency and is therefore not licensable, runs a clinic, and owns the building in which the clinic is housed, and advertises the services of the clinic posing in large billboards by a local highway, seeming to offer his services as a doctor through his clinic. Could that be fee splitting?**

- 3) Fraudulent Billing: Presenting a bill for payment which the physician knows is false.
  - a. Knowing retention of excess Medicaid, Medicare or insurance reimbursements.
  - b. Billing for a higher level of complexity than actually performed.
  - c. Billing for work done by someone else (i.e., a student).
- 4) Tax Fraud
  - a. Hiding income
  - b. Inflating expenses.
- 5) Spoliation of Evidence
  - a. If you change the record in such a way as to attempt to evade detection, in an issue which is in litigation or which you know may soon be in litigation, this is one type of spoliation of evidence. (Murdering witnesses, and burning up murder scenes, of course, are other types of spoliation). If two people get together to do this, it may be not only spoliation, but conspiracy to despoil.
- 6) Price fixing
  - a. If a group of physicians, or a group of health care providers, gets together and agrees to charge a certain fee for a service, this is price fixing; and where these providers can enforce their agreement because they dominate the market, it is against federal law (antitrust law).
    - i. Of course, insurance companies frequently say how much they will reimburse for a given service; and this affects many providers. Why is this not price-fixing?
- 7) Conspiracy in General. Conspiracy is a very slippery and tricky crime, and since business, including the health business, is conducted in groups, it is exceedingly easy to become a party to a conspiracy: for instance, if you are aware that your medical group receives kick-backs from a lab, but you yourself get no direct profit from the kickbacks, you might be a conspirator by continuing to send labs to the kicking-back laboratory, The elements of conspiracy are :
  - a. Knowing active participation...
  - b. In a plan...
  - c. To commit a crime.

## **VII. Post-amble: It's Not Only About Money**

You may have noticed that around Christmas, people get a little strange; also, when they buy land, or stocks. Why? Money is a symbol of many things, including security, power, and safety. People want to be seen as smart, as well, and people who make a lot of money are assumed to be smart. Doctors in general both make a lot of money, and create a great deal of business for others to make money. This seething pot of commerce is a grave temptation to some folks.

Wherein is medicine particularly susceptible to fraud? One main reason is that most medical goods and services are used by one party, but paid for by another. This third party system, frankly, invites collusion between various consumers and purveyors, against the payors.

Another reason is that medicine is about life and death; and yet it is not free. The power to give comfort, or even life, seems magical. All kinds of nefarious people, including administrators and business people, want to be secondarily involved in this magical and potent process, and may try to use you for their own ends.

You must be aware of the pitfalls that lie in your way; and in this area of legal medicine, as in all others, knowledge is power.

The purpose of this course is to empower you, so you will be less afraid and more effective for your patients and for yourself to do that which is best, and right, and meaningful, and helpful to others.

## **VIII. Post-lecture Questions: True or False?**

- 1) Probate is the process of your assets being tied up after your death while an administrator manages them.
- 2) Life insurance proceeds are not probated.
- 3) Life insurance proceeds are not taxed.
- 4) Health benefits payments are deductible from taxable income for a corporation, whether professional or regular.
- 5) Changing the chart in anticipation of litigation is spoliation of evidence.
- 6) Corporate form is desirable because it somehow seems more important.
- 7) Using corporate form, you can shield your practice from medical malpractice liability.
- 8) If your physician assistant goes to work for your competitor, his license is automatically still good.
- 9) Corporate income taxes are due on April 15<sup>th</sup>.

- 10) You have a right to one delay in filing your personal income taxes; but if you would have owed taxes in April, then you will owe interest on those taxes in August.
- 11) If you deduct payroll taxes, but spend them and don't send them in to the IRS, you should reserve your orange jumpsuit now.
- 12) Medical malpractice premiums are deductible either for you, if you pay them, or for your employer, if your employer pays them.

## **IX. Citations**

- a. Abrams and Moy, *Legal Manual for New York Physicians* NYSBA 2003.
- b. *2005 U.S. Master Tax Guide* CCH Publishing (2004).
- c. Furrow, Greaney *et al. Health Law* 2d, West Publishing, Mineapolis, 2004.