

# Leasing Offers Several Benefits

By John W. McDaniel

**H**ospitals are seeking new and innovative ways to affiliate with physician group practices that are much different than the affiliations hospitals used in the 1990s. These new relationships could involve some form of physician employment, meaning both the hospital and physicians would have a more formal business relationship than they have had in the past. In addition, these arrangements could reflect lessons both parties have learned over the years through relationships that were somewhat less than satisfactory.

Every hospital has a physician integration strategy as a part of its overall strategic long range plan, and hospitals are physician-driven organizations. Therefore, hospitals and health systems must explore alternatives to physician affiliation aside from the traditional employment model.

## **Beyond Employment**

For both parties, hospitals and physicians could develop much more meaningful relationships than they have had in the past and these arrangements could go beyond the traditional physician employment and professional services arrangements that were popular years ago.

For strategic reasons, many large hospitals and health care systems and even many small and rural hospitals are likely to be interested in developing new and various affiliation models. The large hospitals

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are seeking to increase their reach in the communities in which they operate and the small rural hospitals are interested in developing these arrangements in part because they have had so much trouble in recent years recruiting physicians.

Experts who study physician-hospital relations say integration between hospitals and physician specialists is occurring at a growing rate in part because hospitals recognize that developing successful partnerships with specialists can enhance revenue. "Specialists have higher incomes than primary care physicians have, and they have money to invest in joint ventures for specialty centers," says Daniel Beckham of the Beckham Co., in Whitefish Bay, Wis. "In some instances, the relationship involves employment. When hospitals directly employ some specialists, the question becomes, what is the inevitable evolution of that model?"

## **A Customer Focus**

When developing new affiliation models, hospitals and health systems should be focusing their attention on their most important customer: the physician. In the past, hospitals have had various employment arrangements with physicians. But many are re-examining those arrangements now in part because the arrangements

they used in the past have under-performed. What's more, some hospitals have found it is not necessary to own a medical practice or employ physicians to develop a meaningful relationship. They also have learned that a merger between two companies does not necessarily strengthen their business relationship.

In the 1990s there were reports that hospitals lost vast sums after purchasing physician practices because once the physicians became employed, they were no longer interested in working as hard as they did when they worked for themselves in their own practices.

While these reported financial losses may have been true in part, there were likely many reasons that hospitals failed to get more from practices they purchased. In any case, hospitals are showing an interest in realigning both parties' various incentives today by developing an alternative to physician employment known as practice leasing.

## **A Nonequity Venture**

A practice lease is a model through which a hospital and medical practice could enter into a nonequity joint venture.

This model helps the hospital develop relationships with its key physicians through a sustainable private practice model. Indeed, a prac-

tice lease could be a solution for hospitals, health systems, and physicians searching for a meaningful affiliation strategy by establishing a centralized mechanism to allow both parties to be involved in improving patient care, enhancing information technology, and using their collective expertise.

### Forming a New Entity

These relationships could be structured in a manner consistent with various Stark exceptions and safe harbors under the federal Anti-Kickback Act.

This structure would involve having the hospital create a new company (let's call it NewCo), through which NewCo could enter into an employment agreement with physicians who are part of an existing practice. The practicing physicians would work solely for NewCo. Given that this entity could be structured as a group practice under the Stark laws, NewCo could compensate the physicians through a combination of salary, bonus, or by offering a share of NewCo profits.

To the extent that NewCo would provide ancillary services in a manner consistent with the in-office ancillary services and group practice exceptions under the Stark laws, each employed physician could share in the profits. Included in this sharing of the profits would be any profit from providing designated health services under Medicare or Medicaid, except under certain exceptions.

### Referral Rules

In addition, the employed physicians may be required to refer patients to a specific hospital for all services unless the patient requests otherwise. The best interests of the patient would dictate or another exception-required referral rule under the Stark laws would apply.

NewCo could contract directly with the practice to provide all or some of the following:

- Space for the physicians NewCo employs

## Strategies for Collections

Many practices struggle when it comes to dealing with accounts receivable. But some practices have procedures in place that help them ensure that payments are collected on time without requiring staff to spend an inordinate amount of time chasing overdue payments.

The practices that have most success with patient accounts ensure that patient statements are sent every 30 days. If no payment has been made after 90 days, these practices send the patient one final demand letter, either requesting payment in full or asking the patient to call the office to make payment arrangements. If, after 10 days, the office gets no response from the patient, these accounts should be referred to a collection activity.

Indeed, the most efficient practices typically have written policies and procedures that outline these approaches to collecting overdue funds. In addition, these practices have appropriate processes in place to define amounts that can be written off. These processes help the practices expedite the accounts receivable process.

One little used tool that practices may find useful involves IRS Form 1099-C. Using this form, the physician would essentially be reporting the debt to the IRS as income to the individual who owes the debt. In this sense, it is a serious tool that is likely to incur the individual's wrath. Therefore, physicians should use this tool with great caution. In essence, it is a technique used to assist in collecting a large outstanding account for a patient you are not likely to see again.

To report income of an individual regarding cancellation of debt, the following conditions must be met:

- The account must be at least \$600
- The accounts must be cancelled and returned from any collection agency
- The practice must have determined that the account is uncollectable in the current year
- The practice must give up trying to collect the account
- The practice must write the account off or remove it from the books.

A better step may be to notify the debtor that the practice intends to report this cancellation of debt as income to the IRS unless payment in full is received or appropriate payment arrangements are made. No one wants to be reported to the IRS or have to pay taxes on such "income" that is basically a cancellation of debt.

—JWM

- Equipment for the physicians NewCo employs
- Practice management services.

Indeed, NewCo and the physicians would need to structure their space and equipment leases and management services agreements in a manner consistent with the applicable Stark law exceptions and the relevant safe harbors under the anti-kickback laws.

This structure would provide physi-

cians with two sources of revenue: employment compensation (salary, bonus, and share of profits) and proper distributions from the practice, which would function as a management services organization. While the benefits to the physicians are obvious, the hospital could enjoy all of the benefits of owning a practice with no significant expenditure of capital. Furthermore, should the venture become unsatisfac-

## Structured Arrangements Can Help Patients Who Struggle to Pay Their Bills

A number of reports are available to most practices with respect to the monitoring of accounts receivable management. These reports include days in accounts receivable or percentage of accounts receivable in excess of 90 days. By reviewing these reports each month, the practice can ensure that its respective accounts receivable fall within acceptable parameters. But physicians and staff must monitor these benchmarks continually.

Indeed, the most efficient practices invest in areas such as accounts receivable that have the greatest opportunity for return on investment.

One strategy that practices can use when a patient has a large outstanding debt is to establish a structured payment arrangement. Since some patients may have difficulty in satisfying account balances on a timely basis, the practice can establish structured payment plans as long as the practice monitors the patient's performance in paying off the amount owed.

These accounts then can be suspended from any collection activities as long as the patient makes monthly payments under the agreement the patient has with the practice.

Recently, *The New York Times* reported on a similar strategy that physicians are using. Car dealers, furniture stores, and other purveyors of big-ticket items are offering no-interest loans to consumers. The article said millions of consumers have arranged financing through more than 100,000 doctors and other providers who offer a year or more of interest-free monthly payments. Obviously, the doctor's bill would need to reach a certain threshold of say \$1,000, and this amount would be after the practice has collected all insurance payments, if any, on the patient's behalf.

Banks and credit card companies are willing to assist physicians who are interested. The drawback would be that patients who fail to make the required payments may find they are penalized by then having to pay a high interest rate on the remaining debt, the article said.

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tory or unsuccessful, this arrangement would be much easier to unwind than a practice acquisition.

### Compensation Considerations

When developing any new venture, hospitals, health systems, and physician groups should be aware of the rules regarding reasonable compensation as outlined in the 2000 EO CPE (Exempt Organizations Continuing Professional Education) text from the Internal Revenue Service (called CPE for FY 2000). The IRS has a series of training arti-

cles on its Web site that are of interest to tax-exempt organizations published as the Exempt Organizations Continuing Professional Education Technical Instruction Program for FY 2000. On the site, there are articles that address the corporate practice of medicine and physician incentive compensation.

In the case of nonprofit organizations, the IRS considers many factors in determining whether the compensation arrangement between a hospital and physician violates any laws against private inurement and imper-

missible private benefit. Since the enactment of intermediate sanctions in 1997 and implementing regulations in 2001, the IRS says physicians who are considered "disqualified persons" risk federal excise taxes for compensation that results in an excess benefit transaction with an exempt organization. This tax ranges from 25% to 200% of the excess benefit. Also, organization managers responsible for the arrangement can be liable for a tax of 10% of the excess benefit up to \$10,000 per person.

### Due Diligence Required

Of course, when hospitals and health systems embark on establishing a more formal organizational strategy with physicians, all parties should be certain to follow due diligence procedures to ensure that all parties agree on the steps to take. The hospital or health system also should take all deliberate steps to ensure the feasibility of the new hospital-physician affiliation model.

The key physician leaders who are likely to be involved in the proposed relationship also should be certain that their opinions are considered when the hospital and health system administrators are discussing the project internally. If possible, it would be best to organize a steering committee of physicians to meet with hospital and health system administrators when developing the strategic vision for the new physician-hospital alignment.

And, finally, physicians should be aware of the rules involving the corporate practice of medicine. Many states have statutes regarding such practice, including California, Texas, and Iowa. These and other states have a variety of exceptions that allow organizations that are not owned or controlled by physicians, such as charitable institutions and professional limited liability corporations, to employ physicians.

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