



## ANOTHER WAY TO OPERATE A HEALTH-CARE FACILITY

State now allows medical foundation option for hospitals, physicians

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For many years Connecticut, like most other states, has prohibited physicians and other health-care professionals from practicing medicine as an employee of a corporation. The legal doctrine was developed in the early days of the 20th century, before the adoption of professional corporation statutes, and is known as the prohibition on the “corporate practice” of medicine.

The Connecticut prohibition was originally expressed in two state attorney general opinions, one of which states that “[al]though not expressly stated in the [licensing] statute, the implication is clear that the practice of medicine and surgery is restricted to individuals and does not include corporations.” See Op. Conn. Atty. Gen. 248 (December 3, 1954). In other words, Sections 20-9 and 20-10 of the Connecticut General Statutes prohibit any person from practicing medicine without a license, and the only persons who are qualified to obtain a license are individuals.

The corporate practice doctrine is rooted in the historic efforts of physicians to maintain their independence and avoid undue influence from large corporations, including hospitals, and to preserve the traditional doctor-patient relationship, free from the predations of Wall Street and the dominance of institutional health-care providers.

In his book, “The Social Transformation of American Medicine,” Paul Starr calls these efforts the preservation of the “sovereignty” of the medical profession, and he argues that it involved the “restriction of competition, the limiting of regulation by government and private organizations and the authority to define and interpret the standards and understandings that govern medical work.”

Needless to say, the economic and political forces that have transformed American medicine in the last 50 years have also rendered the corporate practice doctrine an odd artifact of a simpler age and philosophy. Noteworthy in this history is the fact that the American Medical Association no longer opposes the corporate practice of medicine. However, it is a doctrine that is still very much alive and something that must still be taken into account in planning health-care organizational structures because the consequence of a violation by a physician is the loss of his or her license. See *Lieberman v. State Board of Optometry*, 130 Conn. 344 (1943).

### ‘Friendly PC’

The corporate practice doctrine has not been applied in Connecticut to employees of non-profit hospitals, but hospitals have gen-



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erally established their community-based practices through an organizational structure known as the “friendly PC.”

The central feature of the professional corporation statute is its requirement that all of the shareholders of the corporation be professionals licensed to practice the profession for which it was formed. Because a hospital is not an individual and thus cannot be licensed to practice medicine, if it wants to establish a community-based physician practice as a separate entity, it must form a professional corporation and make arrangements for the professional corporation to be owned by a physician shareholder, typically an employee of the hospital.

Although this structure satisfies the literal requirements of the professional corporation statute, it raises innumerable legal issues that have kept health-care lawyers up at night. For example, it creates very real problems under the Stark Law regulations

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# HEALTH LAW

and the federal anti-kickback laws; it raises questions about how to distribute any profits to the hospital; it presents “thin capitalization” and piercing the corporate veil issues; it arguably subjects the shares of the physician shareholder to attachment by personal creditors or spousal claims in a divorce proceeding; and it raises knotty issues for financial accounting purposes, to name just a few of the more thorny issues.

The General Assembly has responded to concerns about these issues with the adoption last year of Public Act No. 09-212, “An Act Concerning Medical Foundations and Medical Group Clinic Corporations.” The act permits a non-profit hospital or health-care system to organize and become a member of a medical foundation for the purpose of providing professional medical, chiropractic or podiatric services.

This will allow non-profit hospitals to realize economies of scale and respond better to the growing desire of many physicians, especially doctors just entering practice, to avoid the headaches of private practice and work as employees of a non-profit provider. This allows the problems of running a business and dealing with managed care organizations and complex governmental regulations can be dealt with by professional management and staff.

## Boards And Mergers

A medical foundation formed under the act is governed by the Connecticut Nonstock Corporation Act and must be governed by a

board of directors consisting of an equal or greater number of hospital employed providers than non-provider employees, in addition to the independent board members.

A medical foundation may merge with a domestic medical foundation, professional corporation, limited liability company, partnership or limited liability partnership only if the other entity provides the same professional services as the medical foundation. Like a professional corporation, a medical foundation may not engage in any business other than the provision of health-care services, but the act does not prohibit a medical foundation from making investments or owning real or personal property that is incidental to providing the professional services.

An existing corporation that was organized to provide health-care services may now choose whether to bring itself within the act’s provisions by (1) amending its certificate of incorporation to be consistent with the act, and (2) expressly stating in its amended certificate of incorporation that its members or shareholders have elected to bring the corporation within the act. Any provider agreement between the corporation and the state Department of Social Services will remain in effect regardless of any amendment to the corporation’s certificate of incorporation.

While a medical foundation is not subject to the certificate of need laws, the Act does provide that (1) a medical foundation must file its certificate of incorporation and any amendment with the Connecticut Office of

Health Care Access (OHCA) within 10 business days after it files it with the secretary of the state; (2) upon written request by OHCA, the foundation must provide a statement of its mission, a description of the services it provides and a description of any significant change in its services during the preceding year, as reported by the foundation on its IRS Form 990; and (3) the foundation must file a notice with OHCA if it liquidates or ceases operations.

The act requires medical foundation to be operated as a nonprofit; however, there is no express requirement in the act for it to be exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code. The clear implication from the reference to the IRS Form 990 and the legislative history is that the foundation will be tax-exempt. There is a long line of Internal Revenue Service private letter rulings and other authority on what factors will be considered in determining whether an affiliated medical practice will qualify for a federal income tax exemption.

If a hospital or health system elects to form a medical foundation that qualifies as an exempt organization under Section 501(c)(3), it would (1) generally resolve the private benefit and private inurement issues; (2) minimize most unrelated business taxable income concerns; and (3) facilitate support payments to the foundation and the distribution or contribution of profits to a tax-exempt member or other tax-exempt affiliates. ■