TRENDS IN EXECUTIVE AND PHYSICIAN COMPENSATION AND BENEFITS

NCHHRA SCHHRA JOINT SPRING CONFERENCE
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Why Is Physician Compensation Important?

- Physician Compensation has become much more important because of:
  - Compliance reasons
    - Stark, Anti-kickback and False Claims Act implications
  - Business reasons
    - Can hospitals afford productivity based compensation arrangements with physicians?
  - Public policy reasons
    - Is incentivizing physicians to do more work the best method of reducing cost and increasing quality?
Why Is Executive Compensation Important?

Executive Compensation has become more important in recent years because of:

- Public policy regulators concerns re: nonprofit health system’s tax exempt status
  - Congressional inquiries
  - IRS inquiries
  - Media inquiries
- Business reasons
- Public relations reasons
  - Tax exempt health care systems
- Competition for executive talent
What We’ll Cover

• Brief overview of the healthcare and tax-exempt organization laws that govern the payment of compensation and benefits;

• Case studies to demonstrate the practical application of these rules.

• A discussion of what is included in a typical executive or physician compensation and benefits package and its taxation treatment

• Implementation recommendations
The Laws Governing the Payment of Compensation and Benefits
## Overview of Legal Requirements

### Healthcare Law
- Federal Provider Self-Referral or “Stark” law
- Federal Anti-Kickback Statute
- Civil Monetary Penalty Law
- Federal False Claims Act

### Tax Law
- Private Inurement Prohibition
- Private Benefit Prohibition
- Excess Benefit Transaction Penalties
Purpose of the Laws – In General

- Confirm those in positions of power at the Hospital do not receive an unfair advantage, such as:
  - Excessive pay
  - Excessive benefits
  - Pay based upon the volume or value of referrals
  - Pay for withholding or reducing care
Steering Compliance: What is at Risk

- Loss of Section 501(c)(3) tax-exempt status
- Catastrophic financial impact with severe civil penalties
- Criminal penalties, jail time
- Exclusion from Medicare/Medicaid programs
Stark Law Issues Regarding Compensation and Benefits

- Compensation/Benefits must be “Fair Market Value”
- Compensation/Benefits need to be “commercially reasonable”
- Compensation/Benefits cannot “take into account volume or value of referrals”
- Compensation/Benefits (in some instances) have to be “set in advance”
Stark Law Issues Regarding Compensation and Benefits (Summary)

- **Summary of Stark law’s definition of “Fair Market Value”**
  - The value in arm’s-length transactions, consistent with the general market value.
  - “General market value” means the price that an asset would bring as the result of bona fide bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service agreement….where the price or compensation has not been determined in any manner that takes into account the volume or value of anticipated or actual referrals.”
  
  42 CFR § 411-351(1)
Stark Law Issues Regarding Compensation and Benefits

- The Stark law states that a hospital/physician financial relationship is “commercially reasonable” if the arrangement appears to be a sensible, prudent business agreement, from the perspective of the particular parties involved, even in the absence of potential referrals.
Stark Law Issues Regarding Compensation and Benefits

• Compensation and benefits cannot take into account the volume or value of any anticipated or actual referrals of Medicare patients.

• If there is evidence that the compensation and benefits do take into account the volume or value of referrals, then could violate the Stark law even if the compensation is otherwise consistent with FMV and the arrangement is commercially reasonable.
Stark Laws and False Claims Act

• If the Stark law is violated, the federal False Claims Act could be implicated on the basis that claims that stemmed from a Stark law violation should be False Claims.

• This could result in catastrophic fines and penalties based on potential treble damages and statutory per claim penalties.
Stark Law Issues Regarding Compensation and Benefits

- Stark law exceptions require that compensation arrangements between hospitals and physicians who refer to the hospitals be “set in advance”
- Can meet “set in advance” requirement under the Stark special rate in compensation, if “aggregate compensation” “or “time-based” or per unit of service based amount is “set in agreement between the parties before the furnishing of items or services for which the compensation is to be paid.”
- 42 CFR § 411.354(d)(1)
Anti-Kickback Issues Regarding Compensation and Benefits

- Bona fide employment arrangements for furnishing any item or service which may be paid for by Medicare/Medicaid
  - OIG attempting to make this exception more narrow
- Comply with applicable safe harbors to extent possible
- Anti-kickback Safe Harbors require compensation to be consistent with fair market value in arms-length transaction and is not determined in a manner that takes into account the volume or value of any referrals or business otherwise generated between the parties.
FMV According to the Anti-kickback Statute

- No statutory definition
- Safe harbor regulations require FMV but do not define it
- OIG Guidance
  - 1994 Special Fraud Alert
    - “FMV must reflect an arm’s-length transaction which has not been adjusted to include the additional value which one or both of the parties has attributed to the referral between them.”
  - OIG Compliance Guidance for Individual and Small Group Practices
    - “The OIG’s definition of FMV excludes any value attributable to the referrals of Federal program business or the ability to influence the flow of business. Adhering to the rule of keeping business arrangements at FMV is not a guarantee of legality, but is a highly useful general rule.”
Civil Monetary Penalty Issues
Compensation and Benefits

• Cannot pay a physician to withhold or reduce care to Medicare patients. 42 U.S.C.A at 1320a-7a(b)

• Could be implicated with gainsharing or cost-saving incentive compensation.

• This could lead to civil monetary penalties or exclusion from federal health care programs or potential Federal False Claims Act violations.
The Tax-Exempt Organization ("IRS") Laws Governing the Payment of Compensation and Benefits

- **Private Inurement:**
  - An absolute prohibition
  - Prohibits the flow of the organization’s income or assets to individuals who have some significant relationship with the tax-exempt organization
  - Applies only to “insiders” -- directors, trustees, officers, key employees and sometimes staff physicians
  - IRS treats the payment of excessive compensation to insiders as private inurement.
The Tax-Exempt Organization ("IRS") Laws Governing the Payment of Compensation and Benefits

• **Private Benefit:**
  • Derived from the 501(c)(3) operational test – that a tax-exempt organization must be operated for one or more charitable purposes.
  • The organization must primarily serve **public** interests
  • Only **incidental** private benefits are permitted
    • Indirect/unintended; and
    • Insubstantial
  • Restriction applies to any serving private interests – not limited to insiders
The Tax-Exempt Organization ("IRS") Laws Governing the Payment of Compensation and Benefits

- **Excess Benefit Transactions**: (IRC Section 4958)
  - Excise (penalty) taxes apply if a "disqualified person" engages in an excess benefit transaction with a tax-exempt organization.
  - Excess benefit transactions include the payment of excessive compensation.
Who are “Disqualified Persons”?

- Any person in a position to exercise substantial influence over the affairs of the organization at any time during the prior 5 years;
- A family member of such a person; and
- A 35% controlled entity.

- Examples include officers, key employees and sometimes staff physicians

- Similar to the definition of “insiders” under the private inurement prohibition
What is the Amount of the Excess Benefit Transaction Penalty?

• 25% of the excess benefit to be paid by the disqualified person
• 10% of the excess benefit to be paid by any participating organization managers (officers, directors, trustees)

• Reasonable cause and not willful misconduct exceptions to penalty on organization managers

• Additional tax if not corrected
Excess Benefit Transaction “Rebuttable Presumption”

- It will be presumed that the organization did NOT engage in an excess benefit transaction if:
  - Evaluated by an authorized body (e.g., Board, committee) consisting of those not having a conflict of interest who
  - Obtains and considers comparability data (e.g., compensation surveys) so that it can determine if the proposed compensation / benefits arrangement is reasonable and
  - Approves in advance the transaction in reliance upon the comparability data and
  - Adequately documents the basis for its determination.

- 26 CFR 53.4958-6
Documentation Requirements – Rebuttable Presumption Standards

- Terms of the approved transaction
- Date the transaction was approved
- Members of the authorized body present for the debate
- Members of the authorized body who voted for/against the transaction
- Members of authorized body who recused themselves due to a conflict of interest
- Reference the comparability data obtained/relied upon
- Description of how the comparability data was obtained
CASE STUDY 1

• Heartland Hospital is acquiring the community’s largest cardiology group comprised of 15 cardiologists.

• Physicians expect an increase in compensation from what they have been making in private practice with their new employment relationship and want to maximize benefit opportunities.

• Questions:
  • Who takes the lead in negotiating compensation?
  • How is compensation methodology and benefits package determined?
  • How are these concepts explained to physicians during negotiations?
CASE STUDY 1

- What are your first steps to prepare for this new employment?
- What are options for compensation methodology?
- What data do you review to determine compensation?
- Does the hospital have a physician compensation philosophy?
- Are physician benefit packages different from other hospital employees benefit packages?
- If so, how is that justified?
CASE STUDY 1

• Do you use signing bonuses for employed physicians?

• How is compensation for employed physicians linked to the acquisition of their practice?

• How are compensation/benefits monitored on an ongoing basis?

• Is there a covenant not to compete: If so, is it valued as a part of the FMV analysis?
CASE STUDY 2

• Heartland Hospital is in process of selecting a new President/CEO.
• A leading candidate has emerged and wants to talk about compensation.
• What should Heartland Hospital’s Board and HR VP do to prepare as compensation package?
• New President/CEO is hired and she wants to look at compensation and benefits of executive team. What process should be followed?
• What if one or more of the executive team are physicians who practice medicine and refer patients to the hospital?
CASE STUDY 2

- How is executive compensation determined?
- What are the connections between compensation and benefits?
- What type of benefit packages are frequently found in executive benefits?
- What is an executive compensation philosophy and how is it determined?
CASE STUDY 2

• Is documentation of executive compensation important and who? For profit v. nonprofit.

• What role does the Board play in determining executive compensation?

• How does executive compensation become public?
TRENDS IN PHYSICIAN COMPENSATION METHODOLOGY

- Current: production based

- Could be seeing shift to new methodologies based on cost and quality

- Could be seeing shift to guaranteed base salaries with quality and cost incentives
TRENDS IN EXECUTIVE COMPENSATION AND BENEFIT METHODOLOGIES

• Base salary determined by size of hospital and compensation studies

• Incentive opportunities based on financial performance of hospital

• Could see more bonuses developed based on cost and quality

• Severance packages – what is the future?
What is Included in the Typical Executive / Physician Benefits Package?

- **Basic benefits offered to all employees**

- **Enhanced retirement plan benefits**
  - Limited qualified retirement plan enhancements
    - Safe Harbor 401(k) Plan Designs; Permitted Disparity Formulas
    - Nonqualified deferred compensation plans
      - SERP (Supplemental Executive Retirement Plans), 457(b) and/or 457(f) plans

- **Severance benefits**

- **Additional welfare benefits**
  - Supplemental life insurance coverage
  - Additional long-term disability insurance coverage
  - Long-term care insurance coverage
The Taxation Treatment of the Promised Benefits
1. Determine What Rules Apply

- Dictated by type of employer and type of plan
- Only certain types of employers can adopt certain types of plans
  - Governmental entity
  - Tax-exempt organization
  - For-profit company
- Compliance requirements vary depending upon the type of plan
  - Top Hat Plan
  - Excess Benefit Plan
  - Deferred Compensation Plan
2. Consider the ERISA Implications

- Complete Exemption for:
  - Governmental Plans
  - Church Plans

- Complete Exemption for Unfunded Excess Benefit Plans
  - Designed to make employees whole due to the limitations under Code Section 415
  - Not limited to a select group of participants
2. Consider the ERISA Implications (cont.)

- Top-Hat Plan Limited Exception
  - Select group of management or highly compensated employees
  - Exempt from participation, vesting and funding rules
  - Also exempt from fiduciary rules, if plan is unfunded
  - Subject to reporting and disclosure rules, as well as enforcement provisions
  - One-time notification to Department of Labor in lieu of annual Form 5500
3. Determine What Tax Rules Apply

- Section 83
- Section 451
- Economic Benefit Theory
- Section 409A
- Section 457
Section 457 Plans

- Only “Eligible Employers” May Adopt These Plans
  - State governmental entities
  - Tax-exempt organizations

- Various Types of Plans
  - 457(b) Eligible Deferred Compensation Plans
  - 457(e) Bona Fide Severance Pay Plans
  - 457(f) Ineligible Deferred Compensation Plans
Section 457(b) Plan Features

• Similar to a Section 401(k) or 403(b) plan

• Contributions:
  • May accept employee pre-tax salary deferrals and employer contributions
  • Plan maximum: $17,500 for 2014
    • Includes employee deferrals and employer contributions
    • Is in addition to 402(g) limit
  • Special catch-up contribution rules
Section 457(b) Plan Features (cont.)

- **Distributions**
  - Hardship distributions available
  - Available after separation from service
  - Lump sum or installment payment options
  - Distributions from non-governmental plans not eligible for rollover
  - Minimum distribution requirements apply

- **Vesting:**
  - Employee deferrals are 100% vested
  - Employer contributions may be subject to vesting schedules
Section 457(b) Plan Features (cont.)

• Unfunded Status of Nongovernmental Plans
  • Benefits must remain subject to the claims of the employer’s general creditors

• May or May Not Be Paired with a “Rabbi Trust”
  • Assets are “set aside” to fund the promised benefits, **BUT**
  • Assets must remain subject to employer’s general creditors in the event of insolvency
  • IRS Model Rabbi Trust: IRS Revenue Procedure 92-64
# Federal Taxation of 457(b) Benefits (IRS Notice 2003-20)

<table>
<thead>
<tr>
<th>Governmental Entity</th>
<th>Tax-Exempt Organization</th>
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<tbody>
<tr>
<td>• Deferrals reported on Form W-2</td>
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<tr>
<td>• If applicable, benefits are subject to Social Security, Medicare, and FUTA taxes upon vesting</td>
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<tr>
<td>• Distributions are subject to retirement plan withholding rules and reported on Form 1099-R</td>
<td>• Distributions are subject to wage withholding rules and reported on Form W-2</td>
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Section 457(f) Plan Features: Overview

- A type of nonqualified deferred compensation plan
- Usually only funded by employers
- No plan maximums/limits apply
- Deemed earnings usually are credited
- Plan credits remain subject to the claims of the employer’s creditors – a requirement to defer taxation
- Distributions treated as Form W-2 wages subject to income tax withholding and payroll taxes
Section 457(f) Plan Design: Vesting

- **Vesting triggers taxation** – a “substantial risk of forfeiture” is needed to defer taxation

- Benefits usually are subject to forfeiture if an employee is terminated for cause or voluntarily quits / retires prior to a specified date or age

- Benefits usually vest upon:
  - Specified date or age
  - Death
  - Disability
  - Involuntary termination of employment without cause
Section 457(f) Plan Design - Distributions

• Due to the taxation rules applicable to these plans, distributions usually are made only in single lump sum payments.

• The present value of the entire vested benefit would be subject to tax if paid in installments.

• No one wants to pay taxes before they receive the benefit.

• Non-compete provisions and consulting requirements usually are not enough to defer taxation after the termination of employment.
Federal Taxation of 457(f) Plan Benefits

- Vested benefits under a 457(f) plan are treated as “wages”

- Subject to income tax withholding, Social Security, Medicare, and FUTA taxes

- Reported on the Form W-2
IRC Section 457(e) Exception

• 457(f) does not apply to a “bona fide severance plan”

• Waiting on IRS guidance (See IRS Notice 2007-62)

• Likely elements include:
  • Only payable upon involuntary severance from employment
  • Total payments do not exceed 2 times annual Compensation ($260,000 for 2014)
  • All payments are completed by the end of the 2nd year after separation

• If exception applies, severance benefits are treated as “wages” and generally subject to taxation as benefits are paid.
Don’t Forget 409A!

• Avoid:
  • Accelerating payment dates
    • Includes adding certain new payment triggers
  • Changing payment methods, unless in compliance with Section 409A
  • Delaying payment dates, unless in compliance with Section 409A
  • Terminating an executive or physician then rehiring him or her or engaging him or her as an independent contractor
Do’s and Don’ts During the Negotiation and Approval Phase of Physician Compensation
DO

• Develop and follow a policy and process for physician contracting
• Educate medical staff and hospital administration on the reason for physician contracting process
• Require use of time sheets or other form of verifiable documentation before compensation is approved
• Follow use of template agreements with consistent compensation methodology
DO

- Document FMV of all payments made to physicians
- Document work performed before paying compensation
- Document “commercial reasonableness”
- Tie every payment to a physician to a signed written agreement that covers services for which payment is being requested or made
- Maintain database of FMV appraisals or other FMV documentation and of commercial reasonableness documentation
- Carefully define duties in each agreement with a
DO

• Index all physician contracts in database
• Track expiration dates of all physician contracts
• Conduct random internal audits to maintain compliance
• Ask questions and stop process if something does not look or feel right
DON’T

• Let operational or strategic concerns eliminate the need to follow compliance standards when contracting with physicians
  • Ready, Fire, Aim!

• Let physicians’ demands dictate compensation or benefit terms
DON’T

• Let Artificial Schedules Dictate Actions: Speed Kills
  • Many strategic objectives can be achieved legally if enough time is taken to structure it properly
  • Do not allow contracting parties to use artificial deadlines to require a shortcut in the process
DON’T

• Ignore warning signs. If an arrangement feels wrong, ask questions
• Contract with other providers who do not have a culture of compliance
• Make payments to physicians without having a signed and compliant agreement
DON’T

• Disregard need to document FMV
• Disregard need to document commercial reasonableness
• Discuss, analyze, contemplate or in any way take into account volume or value of referrals or anticipated referrals which making decisions on physician compensation
DON’T

• Send careless emails about physician compensation that could be misinterpreted
• Send an email that you would not want a 3rd party or government to review (use common sense)
DO’S AND DON’TS IN EXECUTIVE COMPENSATION AND BENEFITS DETERMINATION

• Nonprofit or governmental hospitals should use a committee of the Board who are independent and have no conflicts
  • Physicians employed by hospital should not be on this committee
• Committee should have an executive compensation philosophy or some guiding principle and should use as much external, independent documentation as possible
• All process should be documented in writing
Documentation Recommendations
To Document or Not to Document . . .
That is the Question

• Each physician employment of independent contractor relationship should have a file that contains
  • Documentation of fair market value
  • Documentation of “commercial reasonableness” or that service is needed
  • Documentation that the services are performed
• Hospitals should be very careful to not inadvertently create any documentation: e-mail, minutes, power point presentation, etc. that could be misconstrued as taking into volume or value or referrals
Documents Approving the Package

- Comparability / fair market value data (e.g., compensation surveys; reasonableness opinions)

- Minutes / resolutions of the authorized body meeting the rebuttable presumption standards
Documents Implementing the Package

- Employment agreements
- Employee benefit plan documents
How to Deal with Problem Contracts
Contract Law Pitfalls in Physician Contracts

- DDGB
- Ambiguity of terms – Intent of parties are unclear
- Unfavorable termination rights
- Governances on compensation
- Non-compete
- Description of services
- Description of compensation/benefits
- Changes in compensation without documentation
Besides the Compliance Reasons, Why is Following the Contract Process Important?

- Breach of Contract
- Ambiguous Terms
- Unhappy Contract Partner
- Unfulfilled Expectations
- Interference with Contracts for competition
General Recommendations

- If FMV or commercial reasonableness is an issue, needs to be determined and confirmed
- Don’t ignore problems that start small and grow into bigger problems
Solutions to Problem Contracts

- If contract is determined to be a problem, there are several self-disclosure options that allow providers to share information and problem with government and this will mitigate risk of False Claims liability
Disclosure Considerations
IRS Form 990

- Form 990 requires listing officers, key employees, and five highest compensated employees receiving $100,000 or more

- If pay exceeds $150,000, Schedule J requires more detail
  - Base compensation
  - Bonuses / incentive pay
  - Retirement and other deferred compensation
  - Nontaxable benefits

- Schedule J also requires disclosure of compensation policies and procedures
Freedom of Information Act

- For Governmental hospitals, keep in mind that executed physician employment contracts and executive employment agreements are subject to FOIA
Questions?

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