Compensation and Benefits for Employed Physicians
Webinar Series

Part Two: December 8, 2011

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Program Overview

> Part One – December 6, 2011:
  - Trends in employment (and other hospital-physician integration) relationships
  - Emerging integration options and structural and regulatory parameters

> Part Two – December 8, 2011:
  - Approval and administration of compensation for physicians
  - Benefits arrangements for physicians: 2012 and beyond

Recordings of each session will be available next week on our website.

> Part One: www.drinkerbiddle.com/compensationbenefitsemployedphysicianspartone
> Part Two: www.drinkerbiddle.com/compensationbenefitsemployedphysiciansparttwo

Approval and Administration of Compensation for Employed Physicians

Linda S. Moroney
Partner
Overview

- Guiding documents
- Shared (participative) authority
- Specific matters for decision-making
- Achieving the rebuttable presumption
Guiding Documents

> Nature, amount and conditions for payment:
  – Employment Agreement
  – Compensation Philosophy
  – Compensation Plan or Policy

> Who decides or oversees, and what process:
  – Bylaws
  – Committee Charter

Guiding Documents (cont’d)

> Fundamental decision (spectrum):
  – Apply single comprehensive comp plan on entity-wide basis (without exception)
  – Apply comp plan with negotiated tweaks as necessary
  – Use different comp plans for each specialty or each practice site
  – Individually negotiate every arrangement
Shared (Participative) Authority

> Pertinent tasks:
  - Development
  - Vetting
  - Approval
  - Implementation

> Participants:
  - Physician leaders or work group
  - Designated executives
  - Compensation committee
  - Board (maybe multiple levels)
Role of Physicians in Setting Comp

> Historical perspective of IRS/courts, re: tax-exempt entities:
  - *Lorain Avenue Clinic* (1958) – no exemption where clinic was controlled by physicians who divided up net profits
  - GCM 32453 (1962) – approved exempt HMO’s payment to private physicians of capitation plus withhold, where physicians had no role in management or control of HMO
  - Rev. Rul. 69-383 – approved comp arrangement with radiologist because negotiated at arm’s length and physician not in control of hospital
  - GCM 38394 (1980) – comp arrangements considered to be “arm’s length” if determined by independent board committee without participation of physician employees

> Historical perspective (cont’d):
  - IDS rulings (mid- to late 1990s) – exemption for physician entities based on various factors, including extent of physician control over comp
    - Comp determined by board or committee (of the organization or affiliated hospital) consisting of persons other than physicians compensated directly or indirectly by the organization
  - IRS template conflicts of interest policy (1997, 2000) –
    - No participation by physicians on board/committee determining compensation
    - However, physicians can provide input to board/committee
      - May not be present for deliberations and voting, however
Specific Matters for Decision-Making

Comp-Related Decision-Making

> Setting the stage:
  - Adoption of Compensation Committee Charter (and changes)
  - Adoption of Physician Comp Philosophy and/or Plan (and changes)
  - Adoption of template Physician Employment Agreement
Comp-Related Decision-Making (cont’d)

> Implementation of comp plan:
  – Recurring periodic/annual matters:
    • Base or guaranteed salaries, or salary ranges
    • WRVU conversion factors, or other market-based adjustments
    • Unique or changed circumstances (e.g., deemed WRVUs, practice logistics, local developments)
    • Administrative and/or supervisory roles and stipends
    • Outside income arrangements
    • Practice objectives or incentive payment criteria

Comp-Related Decision-Making (cont’d)

> Implementation of comp plan:
  – Critical steps:
    • Review past/current performance levels
    • Project future results, considering both:
      – Market changes
      – Practice-specific changes
    • Have candid dialogue accordingly
  – Focus on:
    • Physician buy-in and engagement
    • Control expectations
Comp-Related Decision-Making (cont’d)

> Implementation of comp plan:
  – Mid-year monitoring:
    • Changes in performance levels (from prior year, or seasonal fluctuations)
      – May result in over-draws of compensation, creating prospect of need for substantial repayment at year end
    • Changed personal or professional circumstances
    • Local market developments
    • Mid-year recruitment/site assignments
    • Production levels implicating compensation caps

Comp-Related Decision-Making (cont’d)

> Terms of physician employment
  – Sign-on bonuses and other recruitment features
  – Negotiation of one-off compensation arrangements
    • Documentation accordingly
  – Physician welfare and retirement benefits
    • Employment agreement typically refers to external plans; permit periodic changes applicable to all participants (without need for amendment of employment agreement)
    • Physician-specific benefits may be pressure point
Comp-Related Decision-Making (cont’d)

Terms of physician employment (cont’d):
  - Decisions vary depending on:
    - Duration of employment agreement (periodically renewed versus open-ended)
    - Whether physicians are disqualified persons under IRC Section 4958 (positions of substantial influence?)
    - Anticipated compensation level relative to market

Achieving the Rebuttable Presumption
Achieving the Rebuttable Presumption

> The underlying risk: intermediate sanctions
  - Paying above-market compensation to a physician in a position of substantial influence (a “disqualified person”) results in excess benefit transaction
  - Means penalty taxes will be imposed on:
    - The physician, at 25% of excess benefit, plus another 200% if not timely corrected
    - Organization’s individual leaders who knowingly approved the comp arrangement, at 10% of excess benefit up to $20,000

Achieving the Rebuttable Presumption (cont’d)

> To lessen the risk, follow three-part procedure to achieve rebuttable presumption:
  - Approval by independent board or committee
  - Based on review of amounts paid by comparable organizations for similar services
  - With decisions fully and timely documented
> Independent board or committee?
  - Easier said than done
  - Standard for “independence” here is more rigorous than in other contexts (must be “free of conflicts” under IRC Section 4958 regulations)
  - No physician members
  - If execs serve on committee, need caution in approving comp for physician board members
    - To avoid the “back-scratching” problem, physicians should not participate in executive comp approvals

> Comparative market data?
  - Source and scope
  - Defining appropriate peer group
    - Type of organization/system
    - Size/scope
    - Geographic location
  - Reliance
  - Compensation opinions
    - Comprehensive versus physician-specific
    - Typically will focus on total cash compensation (base and incentive), other benefits, and total compensation
Achieving the Rebuttable Presumption (cont’d)

> Thorough and timely documentation?
  – Tally sheets/summaries must include all compensation
  – Per 4958 regulations, minutes should include:
    • Those present for deliberations and voting
    • Description of the comp arrangement
    • Comparability data obtained and relied upon (including source)
    • Committee’s rationale
    • Date of approval
  – Minutes must be approved within 60 days or, if later, at next meeting of Committee

Achieving the Rebuttable Presumption (cont’d)

> Considerations:
  – Template resolutions may be useful
  – Ensure appropriate tax reporting
    • Forms W-2, 990, etc.
  – Prepare public talking points in connection with particularly high-dollar physicians
Achieving the Rebuttable Presumption (cont’d)

> Risk/benefit analysis re: pursing the rebuttable presumption
  - For all physicians
  - For program, comprehensively
  - For only specific categories of physicians
    - *Per se* disqualified persons
    - Potential disqualified persons (facts and circumstances)
    - High earners, whether or not disqualified persons
    - Other unique payment arrangements or strategic hires

> Even aside from presumption, approval process is still important
Benefits Arrangements for Physicians: 2012 and Beyond

David Wolfe
Partner

Topics for Discussion

> Conceptual Dimensions of Superior Physician Pay Packages
> Special Design Challenges in 2012 and Beyond
> Design Components of “New Generation” Pay Packages under Tax-Exempt Employer Model
Conceptual Dimensions of Superior Physician Pay Packages

The Goal: Developing and Providing a Superior Physician Pay Package

> Promotes physician practice acquisitions
> Promotes physician retention and job satisfaction
> Incentivizes exceptional physician performance
> Facilitates change in physician relationships inherent in federal health care reform
Conceptual Dimensions of a Superior Physician Pay Package

> Focus on overall value of entire package
> Proper performance-driven employer contribution focus
> Balance between pre-tax and after-tax benefits

Conceptual Dimensions of a Superior Physician Pay Package (cont’d)

> Focus on benefit security (from employer’s credit risk) from physician’s perspective
> Focus on retention value
> Take into account value of voluntary benefits and limited perquisites (that promote safety or quality of life)
Special Design Challenges In 2012

- Likely increase in federal income tax rates in 2013 and beyond
- $500,000 deduction limit for individual pay applies to health insurers and their taxable affiliates effective in 2013
  - Limited retroactive application to deferred compensation earned in 2010-2012 and deferred to 2013 or later
Special Design Challenges In 2012 (cont’d)

> Federal debt ceiling legislation to come
  - For example, the debt reduction “Supercommittee” is considering a proposal to cap annual DC plan contributions (both employee and employer) to the lesser of
    - $20,000
    - 20% of the employee’s compensation
  - Announced 2012 limit is lesser of $50,000 or 100% of compensation (plus $5,500 if age 50+)

Special Design Challenges In 2012 (cont’d)

> Restrictive guidance on church plans and 457(f) plans expected
> Code Section 457A applies requirements similar to 457(f) (i.e., inclusion in income upon vesting) for many “tax pass-through” entities that do not allocate substantially all of their income to taxable entities
Special Design Challenges In 2012 (cont’d)

- Likely increasing IRS audits and “compliance checks”
- Incorporation of physician compensation packages in broader corporate risk mitigation strategies

Design Components of “New Generation” Pay Packages under Tax-Exempt Employer Model
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model

> Incentive plans (annual and/or long-term) measuring physician performance in new ways
  - Qualitative measures
  - Efficiency
  - Management roles

Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

> Reexamine supplemental employer contributions for physicians through tax-qualified DC retirement plans
  - Use cross-testing under the IRS nondiscrimination rules
  - Can accommodate differing contributions to subgroups of physicians
  - Contribution levels can be dependent on performance or profitability
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

> Reexamine possible use of tax-qualified DB retirement plans
  - Significant DB benefit accruals can be provided to highly-compensated physicians under IRS cross-testing rules if rank-and-file employees receive a DC profit-sharing contribution of 5% of compensation
  - Future debt ceiling legislation may shift focus back toward DB plans

Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

- Qualified retirement plans maximize benefit security and tax efficiency of this portion of the pay package
- Deferred vesting can enhance retention value
  - ERISA DC plans: 3-year cliff vesting or 2-6 year graded vesting
  - ERISA DB plans: 5-year cliff vesting or 3-7 year graded vesting
  - Church plans: More lengthy vesting period than permissible under ERISA is possible
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

> Reexamine use of HRA retiree medical solutions
  - Employer funded HRA accounts
  - DC format only
  - Employer cost capped at promised dollar amount during specified employment years

Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

- Sums accumulated separately for each covered physician
- Limited tax exclusion potential but nondiscrimination rules must be satisfied
- Accounting rules are manageable
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

> Insured retiree medical benefits for physicians
  
  - Employers can use an insurance product to provide retiree-only medical benefits
  
  - Under health care reform, the nondiscrimination rules that apply to self-insured medical plans are being expanded to cover insured medical plans, but retiree-only benefit plans are exempted
  
  - Insured retiree medical benefits can be provided to physician groups, and no nondiscrimination rules apply

Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

- In order to qualify as a retiree-only benefit, less than two active employees can be covered at any time
  
  - Cannot provide this benefit to physicians who are working but “partially retired,” etc.
  
  - The insurance benefits are not taxable to the retirees, either when the insurance is purchased when the benefits are actually paid
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

- To avoid imputed income for retiree physicians, retiree-only insurance can cover only
  - The retiree physicians
  - Their spouses, tax dependents, and children who have not yet reached the age of 27

> 457(b) Plans
- Employee v. employer contributions
- Separate annual contribution limits
- Taxed and paid out post-employment
- Unfunded benefit subject to employer’s credit risk
- Church plan or top hat plan to avoid ERISA
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

> 457(f) Plans
  - Tax deferral generally permitted only until vesting
    • Earnings can be tax-deferred until paid
  - Great design flexibility - who is covered, amount of benefit provided, specific vesting dates, etc.
  - Unfunded benefit subject to employer’s credit risk
  - Post-severance noncompete clauses likely will not be effective tax-deferral devices under final regulations that are expected to be issued soon

- Must enforce forfeitures if physician leaves voluntarily or is fired “for cause”, in either case before the vesting date
- Church plan or top hat plan to avoid ERISA
- Minimum 2-year vesting period
- Extended vesting period permissible to enhance “golden handcuffs” potential, but continuing use of rolling vesting is very aggressive
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

- Employer contributions can include supplemental amounts at certain predesignated special points
- Generally, no pre-tax employee contributions should be included
- “Retirement” is treated as a voluntary termination

Examples of 457(f) designs
- Deferred payment of long-term incentives over 2-4 years
- Special retention bonus vested 4-5 years later
- Retirement-oriented supplemental benefit payable at a targeted retirement age
- “Team vesting” where vesting is targeted to specific predesignated business point relevant to that team
- Excess benefit plan providing amounts over Code Section 415 limits
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

> After-tax benefits with special leveraged life insurance product
  - Expected rising federal income tax rates should cause physicians to rethink the advisability of continued emphasis on tax deferral
  - Insurance policy loan feature provides investment with the equivalent of pre-tax dollars
  - Golden handcuffs are possible, but somewhat “messy”

– Minimal employer administrative burden if after-tax benefit is paid and physicians make separate purchase of the insurance product
– Vehicle can also be used to “shelter” proceeds from sale of physician’s practice
– Due diligence over the life insurance product is essential
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

- Policy performance is essential
  - Minimum policy interest guarantees
  - Policy loads
  - Realistic performance projections
  - Loan interest accruals v. policy interest credits
- Life insurance products are a “hard sell” within tax-exempt healthcare due to underperforming split-dollar life insurance experience

Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

- Roth-like voluntary savings feature for employee contributions
- Employer contributions can be supplemented at predetermined special points
Design Components of “New Generation” Physician Pay Packages Under Tax-Exempt Employer Model (cont’d)

> Supplemental life insurance
> Supplemental disability insurance
> Current health benefit coverage under broader health plan

QUESTIONS?