THE BUSINESS OF MEDICINE: LEGAL STRUCTURES AND TAXATION

Saturday, January 6, 2024

From 11:00 AM to 12:00 PM EST

(60 minutes)

Presented By:

Lynda Dilts-Benson, RN, CCM, LHRM, CRC

Pariksith Singh, M.D.

Alan Gassman, JD, LL.M. (Taxation), AEP® (Distinguished)
agassman@gassmanpa.com

1245 Court Street
Clearwater, FL 33756

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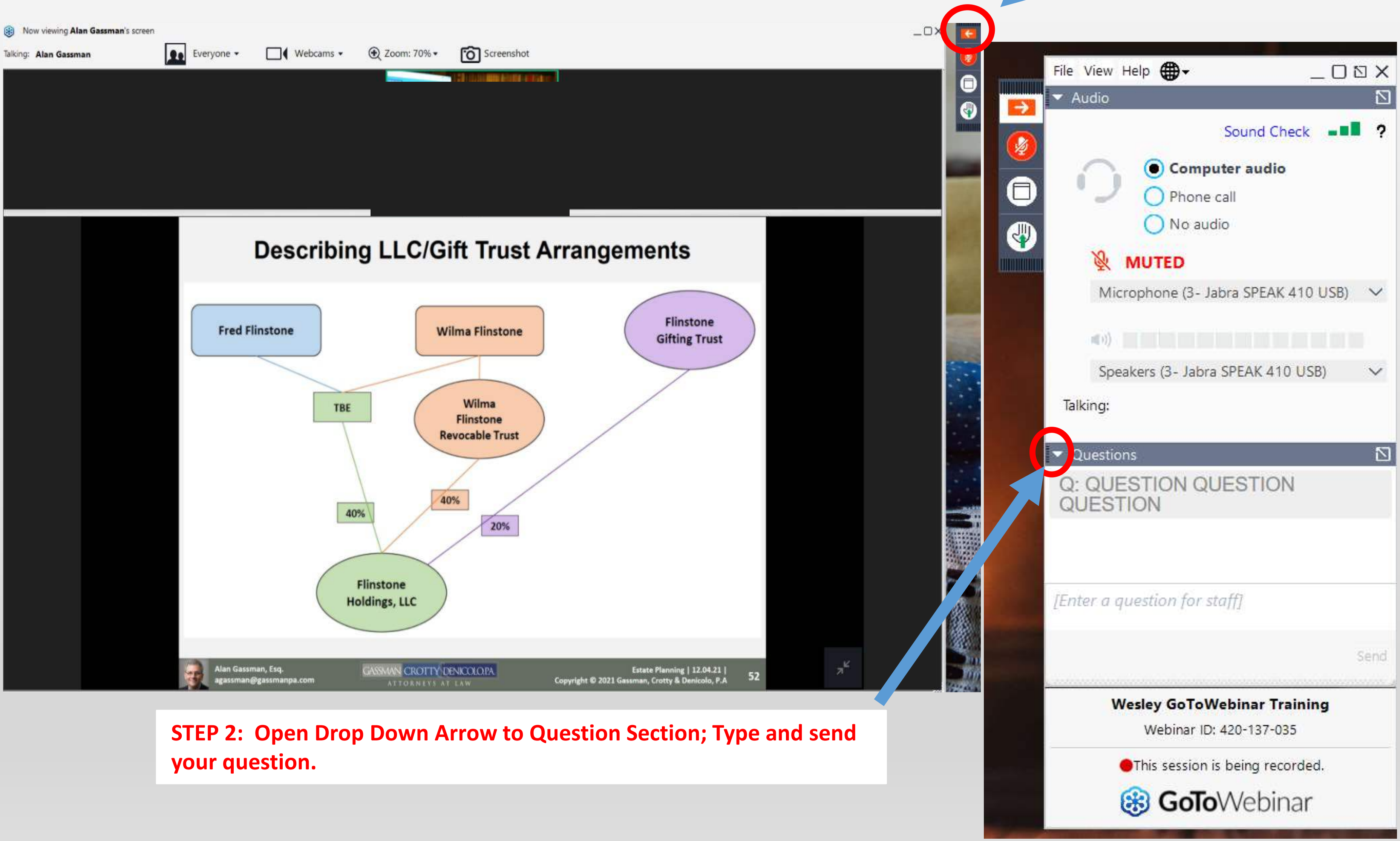

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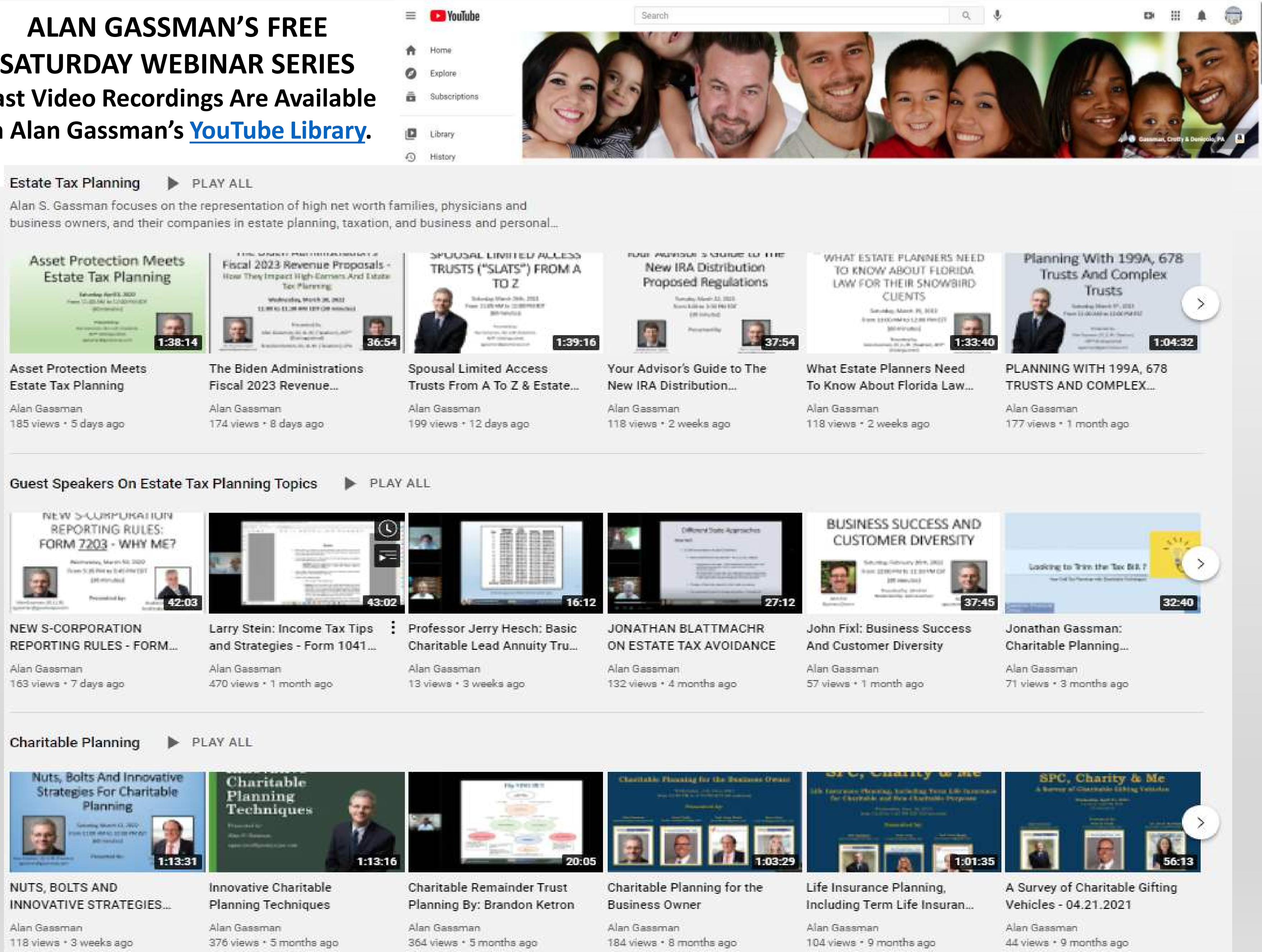

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Friday, December 15, 2023

58TH ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING™
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Issue #342

Coming from the Law Offices of Gassman, Crotty & Denicolo, P.A. in Clearwater, FL.

Edited By: Alan Gassman

Article 1

Come See Us At Heckerling

Written By: Alan Gassman

Article 2

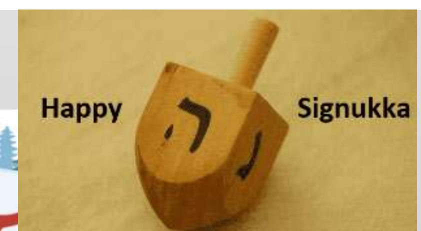
Lower Interest Rates Are Coming To Town

Written By: Brandon Ketron & Alan Gassman

Article 3

Why a King Clause Is Better Than A Wandry Clause

Written By: Alan Gassman & Brandon Ketron



SCHOOL OF LAW
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When will the 58th Annual Heckerling Institute on Estate Planning be held?

The 58th Annual Heckerling Institute on Estate Planning will be held in Orlando, FL on **January 8-12, 2024.**

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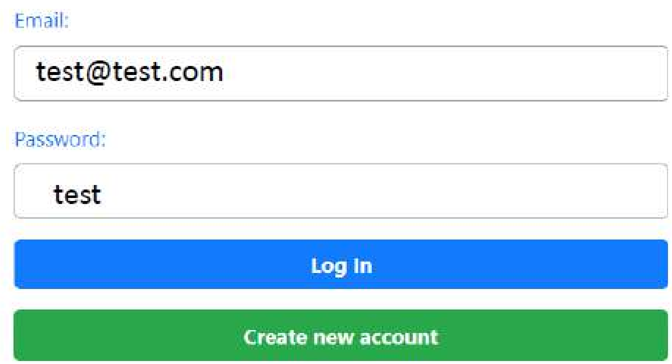
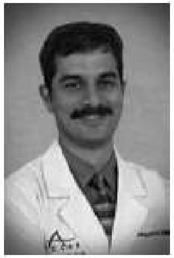
2. Use the following credentials
to **Log In** to EstateView.
(You do not need to Create a new Account.)

In the email section, type in test@test.com.
For the password, type in the word test.



This is a preliminary version we are still developing. Additional techniques will continue to be added. We are providing this version at no charge so that you can evaluate the program for a technique and provide comments that can improve the ability to use EstateView.

A Preface by Dr. Pariksith Singh



I was very pleased when Alan asked me to write a preface to his book. We have worked together on my personal planning for over 10 years, and have exchanged ideas and written together on many topics. I have learned much from him, and each time I review the plan that he established for us I am impressed that it has withstood the test of time and needs very little changes notwithstanding our business and family growth and maturation over the years. I am pleased that he indicates that he has learned a lot from me as well.

Before Alan worked on my planning I attended a 3 hour lecture that he was commissioned to give for lawyers and accountants on business, estate planning and asset protection law for physicians. There were over 400 pages of materials, and he had to move fast to even introduce all of the topics that needed to be covered. Everyone was taking notes as quickly as they could. Hats off to him for all of the work that it must have taken to bring these subjects to the level of understanding for physicians and advisors who are not specialized tax, business and estate planning lawyers. This is a very impressive book.

As with any good book, it is easy to get lost in the trees while trying to understand the forest. While Alan does a very good job helping to distinguish between forest and tree, I thought that it would be good for the reader to have access to my shorthand guide that is based on my personal experience, and not necessarily everything that can and will happen to each of my colleagues.

Over the course of almost two decades as a physician, I have attended a University that most of us attend, sometimes without realizing, and have taken its courses as diligently as possible. This is the greatest University in the world, also known as the Harvard School of Hard-Knocks, the John Hopkins of Real-Life or the Ivy League of Hits and Misses.

It is a very painful and rewarding journey. There are hundreds of self-confessed teachers or guides, and many of them will easily mislead you. I too have been misled, taken advantage of, lied to, and defrauded of my hard-earned money. I too have made a lot of mistakes. Fortunately, the good things I did outpaced my errors and kept me afloat. Good advisors that I could trust were very important and helpful, when I listened to them! If only I had called them in more often.

I realize I have been very fortunate. My business could have easily gone down the drain like many others. I could have been bankrupt just like other physicians that I have been closely involved with. There were times when I did not know where the money for payroll was going to come from which was due the next day. There was a time when all of our profits made were lost to problems caused by easily preventable errors.

I realize now that understanding is a blessing that must be earned and then developed and appreciated. You can avoid much of the rigmarole of attending the more painful courses in the University of Life by learning in advance from others in order to more readily accomplish life goals, whatever they may be. It is in this vein that I share my understanding with fellow physicians about what a good business plan for a physician should or should not entail, and why the reality is that you have to understand some basic concepts and put things in order without exception, in order to have a financial and personal base to work from.

I prefer the term Business Planning to Asset Protection since I favor a comprehensive approach to one's business. While the safety and security of assets is vitally important, physicians must plan for long-term returns, have growth and personal satisfaction in the medical practice, take care of family and children and create appropriate trusts, retirement planning, corporations and other tax and health law compliant structures while fulfilling charitable goals and other primary objectives. Don't let the hurry to check e-mails, read the newspaper, and attend cocktail parties distract you from having a firm base to work from. Castles built in the sand don't last long!

The creation of a plan and system to protect acquired assets and to enhance and grow a business and profession helps in the development of short term goals and in the avoidance of impulsive or imprudent investments that can cause your hard earned money to fly out the window. Please focus on your long term disciplined plan to maximize what you achieve for yourself, family and others. This book can help you do this.

There are some common business errors to avoid right from the beginning, to my mind. These are:

1) Business planning

   a) The structure of your business has to be right, and it is clearly best to make it right from the beginning. I have seen many instances in which the physician did not place his or her business under a legal entity. A properly created and managed corporate entity which holds and controls the business is the first firewall against litigation.

b) Do not mix entities. Do not mix personal with business. Your practice is not you, even though emotionally it may feel that way. If you happen to own separate businesses, keep them separate. The business should be owned separately perhaps from any other holdings, like real estate and vehicles.

c) Run the corporate entities in a clean arm's-length manner as if it were separate from you, which legally it is. Keep proper books, accounts, operating agreements and corporate records in a safe place, preferably after scanning them in a safe server.

d) Make sure your spouse or significant other knows where all your documents are, how or where to access them in case you are disabled or deceased, and who the consultants are that need to be contacted in case of your demise.

e) The approach to business has to be right; practicing medicine is a service, a vocation and a profession but it is also a business. Hire competent and professional help. Avoid using family and friends for office or business work. Create proper policies and procedures for the business and, once created, adhere to them.

f) A systems approach is needed, which would entail looking at the overall picture, the environment, the community, processes, and personnel. Every practice is different. Know your niche and turn your challenges into advantages by working hard on them. Learn from your seniors and experts by being humble and accepting that you do not know everything. Expertise in medicine does not mean expertise in business, law, accounting or finances. Study and research this subject as if your's and your family's life depends on it, which it does.

g) Hiring the best personnel is key to a successful business and the most difficult endeavor. A lot of people need to be screened to find loyal and capable and efficient help. One must take one's time to hire competence and lose no time to fire incompetence.

h) How will you deal with patients and train your staff to deal with them? This is very important. Constant training is a must. Employee morale and education are vital areas. Create the efficiency of a McDonald's or a Starbucks with the service of a Ritz Carlton or Walt Disney. Excellence and quality should be your mantra and should be the motto of every employee in your practice.

i) Hire the best consultants and professionals in all aspects. Not those who will agree with whatever you ask them to do. Not those that cost the least, nor those who get a commission out of your investments. Try to only use reputable and certified professionals who have much experience with physicians, a reputation to protect, and who will be honest on what they know and what they don't know, and what they think you need and don't need. Pay these professionals by the hour so that their motivation is to provide you with services instead of "professional products." Then listen to them even if they disagree with you, and especially if they disagree with you. Do not expect or force your consultants to always agree with you; a good consultant will always give you the best advice whether you like it or not. Let your professionals interact and work together as a team so that major issues don't fall between the cracks. For example CPAs and lawyers need to be in sync so that tax, business and estate planning are properly aligned. One good professional can catch another's error or failure to address an issue if they work together as a team.

j) Get the best coverage. It is a fallacy that going bare or with minimum coverage will mean less liability or less lawsuits. Look to get good umbrella coverage. Remember, you are looking at an overall business plan, not creating a fly-by-night operation. Do not forget tail coverage or prior-acts coverage when you change practices. It is not as difficult to get, nor expensive, as many people think. Never change patient chart documents once a malpractice lawsuit is filed; that is a sure way to lose a lawsuit and the ability to have malpractice insurance in the future. Good record-keeping is mandatory for a good practice. If you see a mistake, never try to cover it up; fix it the right way.

k) Stay ahead of the future. The new medicine is less forgiving but also very rewarding to those who understand what is happening. Bring your practice to focus on an intensive compliance program which would include appropriate coding, documentation, licensure and disclosure. Data and its analysis will drive future health care. Do not be afraid of pay for performance; rather, create parameters and practice indicators for yourself before the government asks for them. Utilization review, disease and population management, and well-being/preventative health are the new trends in medicine. These are here to stay. If you are adaptable, you will become a better business and practice. Evaluate yourself constantly.

l) Do not retire too soon; stay on top of things until you are ready. Do not sell your practice out of fear. Make sure you do appropriate reference checking on potential buyers and involve CPAs and lawyers with experience in this area before you consider selling.

m) Protect your license, as it is your biggest asset. Do not indulge in risky activities, such as driving under influence, seeing female patients without appropriate chaperones, billing fraudulently, sexual harassment, unprofessional behavior, etc. They are just not worth it.

n) Each person is a potential patient or a potential lawsuit; be nice and professional all the time, whether you are in public or private. Treat everyone with due respect, as they should be.

o) Divorce is a very bad business plan. Think ten times before you jump into divorce. It is not only traumatic emotionally and mentally but also professionally. Communicate with your spouse and honor/respect/love them and get independent counseling even if you are sure that you don't need or could not survive it.

p) Learn to be bold once you have mastered the business. You do not stay at home until all the lights turn green, do you?

q) Be careful with picking partners. A business partner is equivalent to your spouse. Bad business partners grow like cancer on the practice. As a rule, do not bring partners into your practice until you involve the specialist consultants and have a clear Operating Agreement and mechanisms to resolve disputes. Treat your partner with fairness and respect. Don't confuse friendship and family with business compatibility. Have zero tolerance for dishonesty or bad intentions with anyone you deal with.

Estate Planning

a) The time to start is now. Do not wait. A good business plan includes good estate planning.

b) Don't be cheap; Hire the best advisors that you can afford. In the long run they cost much less than doing this the wrong way or having to redo it later, or when it might be too late.

c) Be clear about what you want with your trusts and bequeathing; remember Warren Buffet who was very clear about what he wanted to do with his billions. You do not want to take the incentive to work hard from your children, and you do not want them to become stupid because they have rich parents. As Buffet said, "I want my children to have enough so that they can do anything; but I do not want them to have so much that they do nothing."

d) First do no harm; do not sign up with life insurance policies or retirement plans or investment brokers without proper research and checking with your honest hourly professionals. Life insurances can be great tools for asset protection, investment, retirement planning and life-transforming events for the family but one must carefully review the agents' commissions, cash value, guaranteed return, and penalties on early cancellation before signing up. Avoid 419 plans for tax savings.

e) Do not be cash poor. Liquidity is important for any good business plan. Keep enough cash or liquidity to cover your expenses for at least 6 months. Learn to create a nest egg which should only be invested in conservative portfolios. You can be aggressive with play money. Again, discipline is essential.

f) Focus on the core business; do not think that since you are a good doctor, you are a good businessman in every possible field, e.g., running restaurants, gyms, health food stores, gas stations, etc.

g) Take advantage of the yearly gift tax and the $10,240,000 per couple 2012 exemption for estate taxes; do not forget the exemptions for generation skipping estate tax and review these items with a competent tax and estate planning attorney. Your personal lawyer can bring in an expert to help him or her—let them know that you expect and appreciate this. Lawyers are not always keen on bringing in help. Make sure your lawyer can and will.

h) Do not give your children a job in your practice at the highest level right at the beginning. Let them work at a friends office who will show them 'tough love' and will treat your children as you would treat theirs. Let the children learn the value of a hard day's work and enjoy the fruits of their labor. Preferably, let your children have their first job somewhere other than your own practice or business.

3) Growth Strategies: These are part of your overall business plan. Remember, 9 out of 10 businesses fail. Many do so after enjoying a brief period of success at the very beginning and fail only when the growth is not managed properly. "Unplanned growth is the philosophy of a cancer cell," as has been aptly noted by Mirza Yawar Baig, a friend and consultant. Growth without profit has no meaning. The principles mentioned above should be applied constantly at periodic intervals to assess the state of one's company and one should always be ready to kick the tires, so to speak.

4) Ownership: it is key to understand that ownership of certain assets can be risky and should be managed well, e.g., cars, home, boats, etc. These are best addressed with a tax and estate planning attorney. Briefly, unprofitable or risky entities like cars or boats or planes should not be owned by an entity that also owns profitable or valuable lines of business, e.g., one's business or real estate. Also, one should instill the value of avoiding risky behavior among one's children. If they get involved in accidents under DUI or the influence of drugs, that is extremely dangerous to one's financial viability. A recent example of this scenario is Hulk Hogan, aka Terry Bolea, a case that involved damages in excess of 10 million, a tragic trauma to a young Marine, enormous stress and bad publicity. Have plenty of insurance as well.

This is but a brief review of the do's and don't's of a good business plan. All of these recommendations are culled from practical experience or direct or indirect observation and it is my hope that you will avoid learning these lessons in the University of Hard Knocks. Rather, you will study the subject or involve the experts so that this most valuable aspect of your life is made as fool-proof as possible.

Good luck and best wishes to a happy and prosperous productive life. I hope that this preface and the book are a good beginning.

Pariksith Singh, M.D.

TABLE OF CONTENTS

Definitions

- **S Corporation:** a corporation or limited liability company (LLC) that affirmatively elects to be treated as an S corporation for federal income tax purposes by filing Form 2553
- **C Corporation:** a corporation that does not make an S election, including a LLC that affirmatively elects to be treated as a C corporation for income tax purposes by filing Form 8832

Definitions

- **Partnership:** an entity, which may include an LLC or a limited partnership (LP), formed under state law that is treated as a partnership for federal income tax purposes
  - Entities taxed as partnerships do not pay any federal income taxes—somewhat like an S corporation, the income and deductions of the entity flow through to its partners
- **Limited liability company:** an entity that may be taxed as an S corporation, C corporation, partnership, or “disregarded”

Definitions

- **Disregarded LLC:** the income and deductions of the disregarded LLC go directly onto the income tax return of its 100% owner—that may be the Schedule C (for a business or a medical practice) or Schedule E (for a rental activity) on the IRS Form 1040

Basic Income Tax Operations

Shareholder
(Dividends are taxed)

C CORP
TAXED ENTITY

Shareholder
(Dividends are not taxed)

S CORP
TAXED ENTITY

Partners
(Individuals, S corporations or otherwise)
(Distributions are not taxed)

PARTNERSHIP
TAXED ENTITY

PROPRIETORSHIP
(DISREGARDED
ENTITY)

C CORPORATIONS

- Entity is taxed for income at 21%; shareholders taxed for dividends and distributions.
- Corporate level tax–revenues minus deductible expenses
- Contribution of appreciated assets can trigger tax unless the 80% rule is followed under IRC Section 351.
- Income is triggered if an appreciated asset or accounts receivable are transferred from the C corporation to shareholders unless it is deductible compensation.
- Dividends are not deductible expenses.
- May deduct healthcare and disability insurance expenses under certain circumstances.
- In the highest individual tax bracket on the first dollar of income if this is a personal service company.

S CORPORATIONS

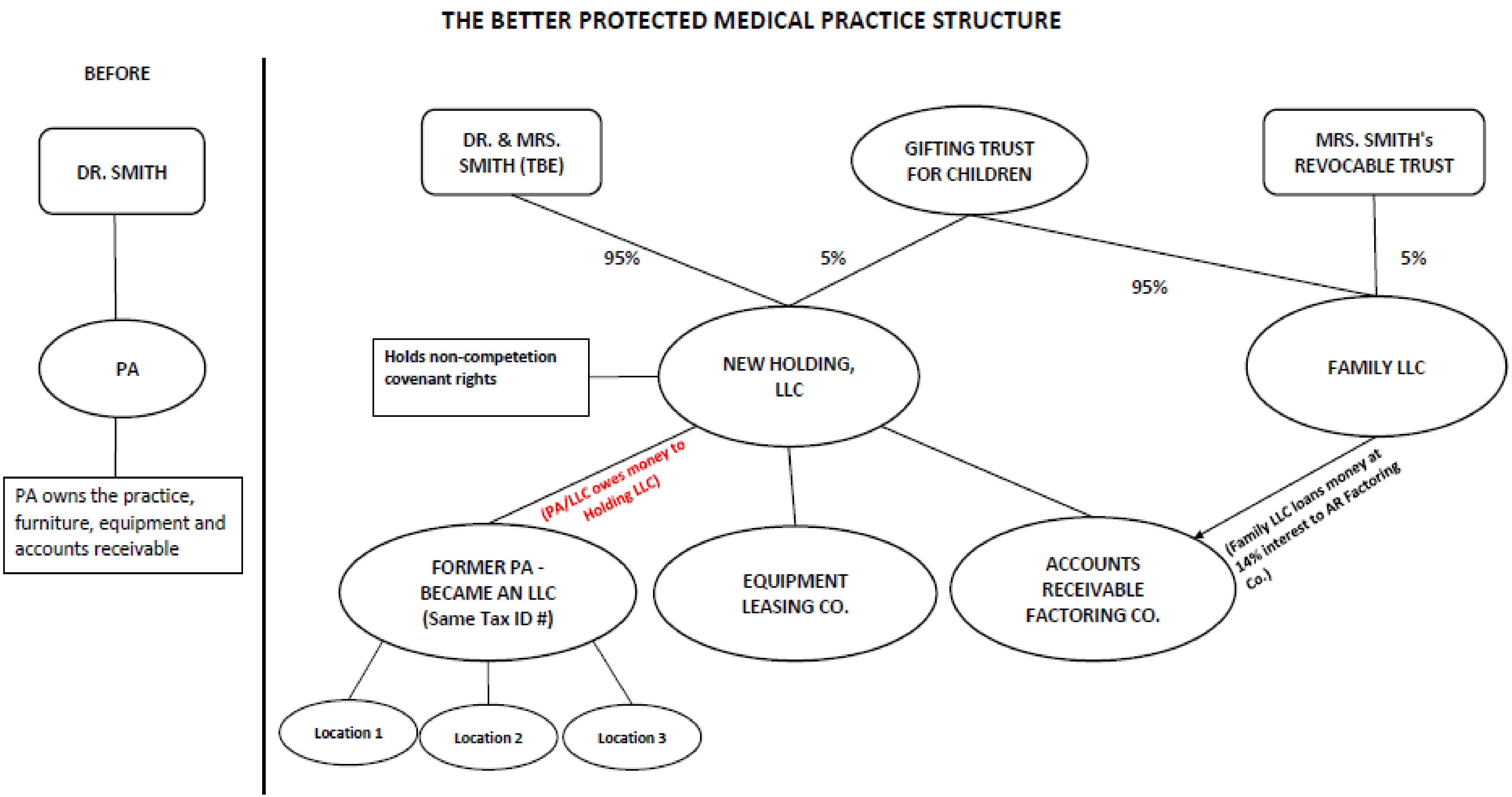
- Owners are taxed at individual rates for salary and income of the company.
- Income and deductions are computed and then go on income tax returns of owners by K-1 reporting.
- Contribution of appreciated assets can trigger tax unless the 80% rule is followed under IRC § 351.
- Income is triggered if an appreciated asset or accounts receivable are transferred from the S corporation to shareholders unless it is deductible compensation.
- Special rules apply if an S corporation used to be a C corporation. This can cause double tax.
- Shareholder might be afforded the benefit of the 20% § 199A deduction.

PARTNERSHIPS

- Income and deductions are computed and then go on income tax returns of owners by K-1 reporting – no entity level tax.
- Distributions to partners are usually subject to employment taxes
- Compensation paid to partners is often called “guaranteed payments” and reduces partnership income
- Typically no income tax is triggered when appreciated assets are contributed to the partnership in exchange for a partnership interest
- Typically no gain is triggered when the partnership transfers appreciated assets to its partners to redeem their ownership interests.
- Partner might be afforded the benefit of the 20% Section 199A deduction.

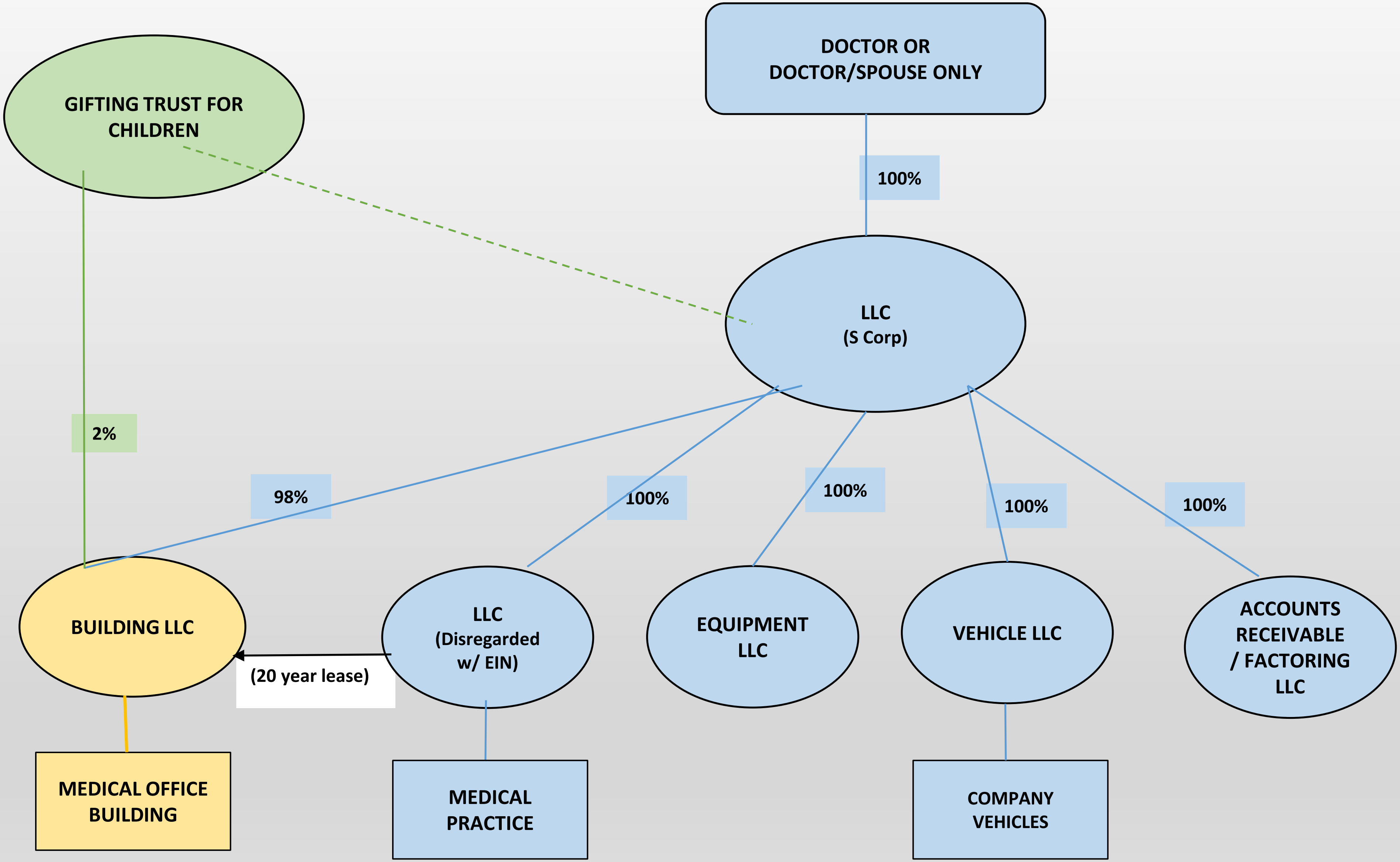
PROPRIETORSHIP

- All income and deductions are shown on individual’s Form 1040 Schedule C – subject to employment taxes of 12.4% on the first $137,700 of income, plus the 2.9% Medicare tax, making for a 15.3% tax thereon, plus the 2.9% Medicare tax on income from $137,700 and an additional 0.9% Medicare tax to the extent of self-employment income that exceeds $200,000 for a single taxpayer and $250,000 for a married taxpayer.
- Owner might be afforded the benefit of the 20% Section 199A deduction.


THE BETTER PROTECTED MEDICAL PRACTICE STRUCTURE
BEFORE
DR. SMITH
PA
PA owns the practice, furniture, equipment and accounts receivable
DR. & MRS. SMITH (TBE)
GIFTING TRUST FOR CHILDREN
MRS. SMITH's REVOCABLE TRUST
95%
5%
95%
5%
Holds non-competetion covenant rights
NEW HOLDING, LLC
FAMILY LLC
(PA/LLC owes money to Holding LLC)
(Family LLC loans money at 14% interest to AR Factoring Co.)
FORMER PA - BECAME AN LLC (Same Tax ID #)
EQUIPMENT LEASING CO.
ACCOUNTS RECEIVABLE FACTORING CO.
Location 1
Location 2
Location 3

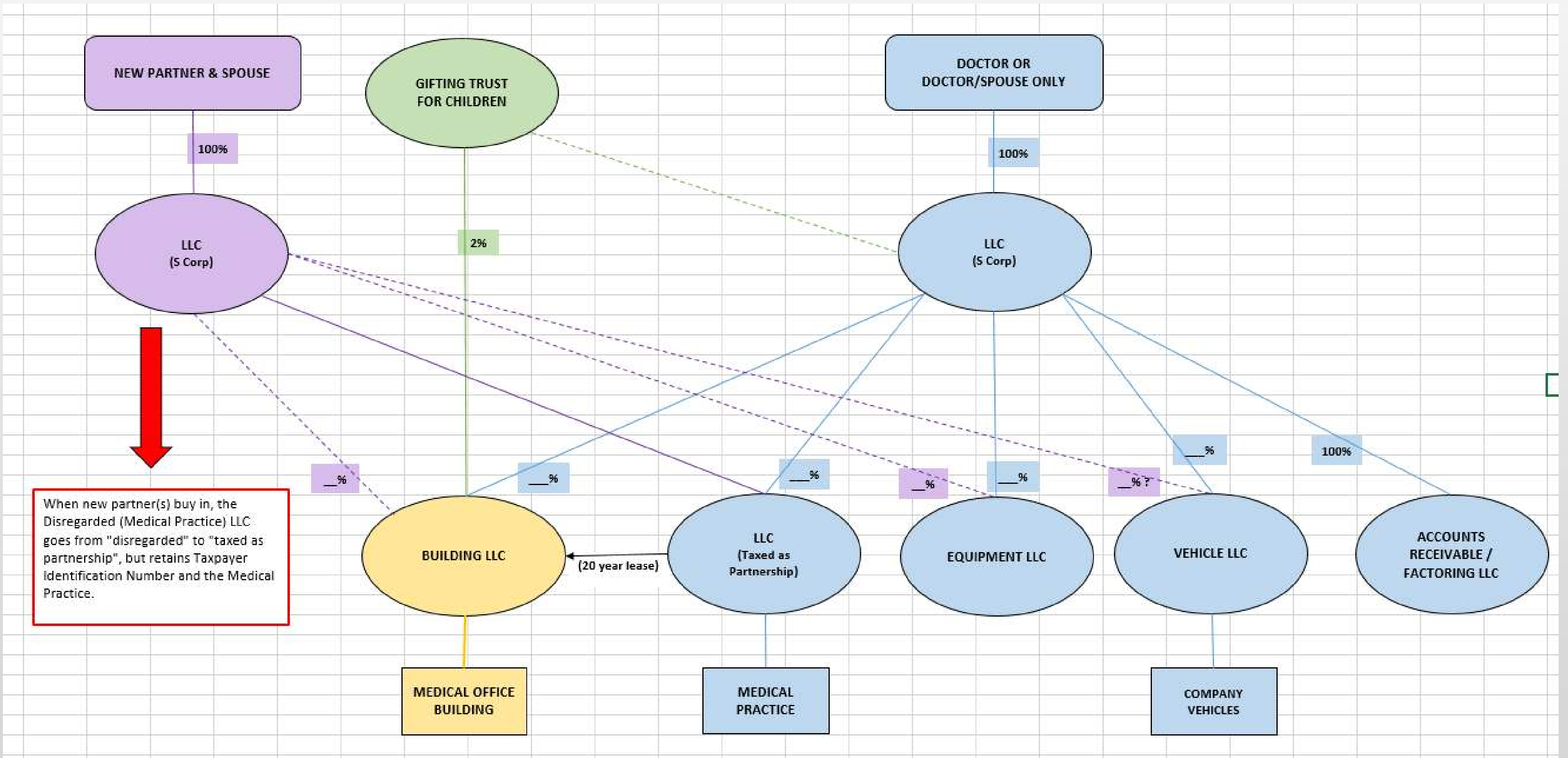
SMART OWNERSHIP OF A MEDICAL PRACTICE

ONE OWNER DOCTOR & SPOUSE – MORE PROTECTIVE

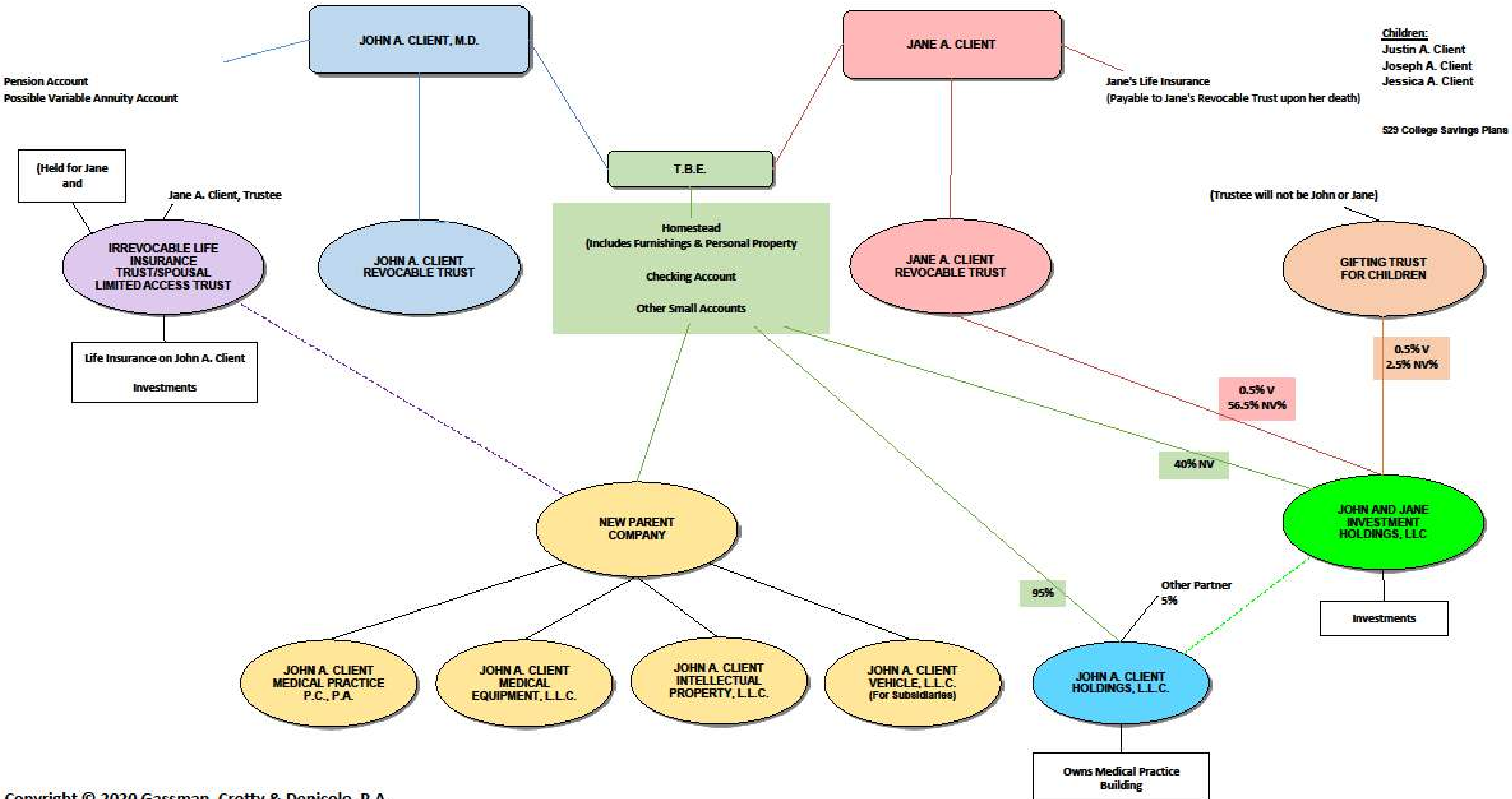


SMART OWNERSHIP OF A MEDICAL PRACTICE

AFTER NEW DOCTOR & SPOUSE ARE ADDED TO PREVIOUS SLIDE (#3) SITUATION



POSSIBLE CLIENT
ILLUSTRATION
PLANNING CHART



J:\G\Gassman\SEMINARS\2020\1.21.20 - Distinguished Speaker Series - Community Foundation of Sarasota County (Venice)\New Illustration Planning Chart.1 Sterilized

:dlg 1/11/2020

OPTIMIZE QUALIFIED PLAN CONTRIBUTIONS

Confer with a Good Actuary

- Quite often clients are underserved with respect to retirement planning. This is often the result of product or general brokerage houses and banks that sponsor simple retirement plans without extensively trained planned design and maintenance personnel.
- One example is the possible use of a 401(k) plan that uses the 3% safe harbor. Such a plan can be set up so that the 3% contribution is not required. The client can decide before the end of each year whether the safe harbor contribution will be made for the year, and must give notice to all participants by the end of November stating whether or not the 3% contribution will be made. This is often known as the "flexible safe harbor" or "maybe safe harbor" or "wait and see safe harbor plan." Many physician groups should be checking with their pension advisors to see if their plan has the flexible safe harbor feature. A plan with a required safe harbor match cannot be managed on a flexible basis.
- Appropriate pension planning can also include cross-testing and defined benefit planning.

Employee Census

Name of Employer:

Provide complete information for all employees employed during the year, even if they have terminated.

Employee Name	Date of Birth	Date of Hire	Date of Termination	Annualized W-2 Compensation	Hours per Week	Ownership %

Optimize Qualified Plan Contributions
(courtesy of Jim Feutz, Suncoast Pension & Benefits Group, Inc.)

- On the following page, we have an example of an allocation of benefits as between a physician, his spouse who is the office manager for the practice, and 4 employees, using a flexible 401(k) plan.

- This client had been told that "all that they could do economically" was a SIMPLE IRA Plan because the client has four other full time employees.

- As shown on the following page, the physician and his wife would benefit from 89% of the plan contributions, with the four other employees sharing 11%, part of which is subject to vesting requirements of 20% per year over 5 years. Most physician groups would not be aware of this type of opportunity.

Optimize Qualified Plan Contributions

(courtesy of Jim Feutz, Suncoast Pension & Benefits Group, Inc.)

Flexible 401(k) Plan for Charles Allen, M.D., P.A.

Name	Position	Earnings	Age	Employee Deferrals	Profit Sharing	Total to Employee	Employer Cost	% of Total
Charles Allen	Owner	250,000	46	17,000	33,000	50,000	50,000	62.7
Ann Allen	Mgr	82,000	46	17,000	4,100	21,100	21,100	26.5
Sub-Total		332,000		34,000	37,100	71,100	71,100	89.2
Jan Brown	Staff	76,267	47	763	3,813	4,576	3,813	4.8
Mindy Garcia	Staff	24,980	43	250	1,249	1,499	1,249	1.6
Alice Jenkins	Staff	39,503	29	395	1,975	2,370	1,975	2.5
Sue Mayfair	Staff	18,960	40	190	1,555	1,745	1,555	1.9
Sub-Total		159,710		1,598	8,592	10,190	8,592	10.8
Total		491,710		35,598	45,692	81,290	79,692	100.0

Optimize Qualified Plan Contributions
(courtesy of Jim Feutz, Suncoast Pension & Benefits Group, Inc.)

- The following page is an example where the owner employs her son. Note that the physician is able to get the maximum $55,500 (since she is over 50) even though she only takes compensation of $130,000.

- The plan also covers Ann Mitchell, a highly compensated assistant, who is not an owner. If desired the plan could totally exclude Mitchell which would reduce the contribution by $3,630.

IRS Form 1120 for a C Corporation

- Page 1 of 6

Form **1120** Department of the Treasury Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2021 or tax year beginning ______________, 2021, ending ______________, 20 ____

▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123

2021

A Check if: 1a Consolidated return (attach Form 851) ☐; b Life/nonlife consolidated return ☐; 2 Personal holding co. (attach Sch. PH) ☐; 3 Personal service corp. (see instructions) ☐; 4 Schedule M-3 attached ☐	**TYPE OR PRINT** — Name; Number, street, and room or suite no. If a P.O. box, see instructions.; City or town, state or province, country, and ZIP or foreign postal code	**B** Employer identification number; **C** Date incorporated; **D** Total assets (see instructions) $

E Check if: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change

Income

1a	Gross receipts or sales	1a	
b	Returns and allowances	1b	
c	Balance. Subtract line 1b from line 1a	1c	
2	Cost of goods sold (attach Form 1125-A)	2	
3	Gross profit. Subtract line 2 from line 1c	3	
4	Dividends and inclusions (Schedule C, line 23)	4	
5	Interest	5	
6	Gross rents	6	
7	Gross royalties	7	
8	Capital gain net income (attach Schedule D (Form 1120))	8	
9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)	9	
10	Other income (see instructions—attach statement)	10	
11	**Total income.** Add lines 3 through 10 ▶	11	

Deductions (See instructions for limitations on deductions.)

12	Compensation of officers (see instructions—attach Form 1125-E) ▶	12	
13	Salaries and wages (less employment credits)	13	
14	Repairs and maintenance	14	
15	Bad debts	15	
16	Rents	16	
17	Taxes and licenses	17	
18	Interest (see instructions)	18	
19	Charitable contributions	19	
20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)	20	
21	Depletion	21	
22	Advertising	22	
23	Pension, profit-sharing, etc., plans	23	
24	Employee benefit programs	24	
25	Reserved for future use	25	
26	Other deductions (attach statement)	26	
27	**Total deductions.** Add lines 12 through 26 ▶	27	
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.	28	
29a	Net operating loss deduction (see instructions)	29a	
b	Special deductions (Schedule C, line 24)	29b	
c	Add lines 29a and 29b	29c	

Tax, Refundable Credits, and Payments

30	**Taxable income.** Subtract line 29c from line 28. See instructions	30	
31	Total tax (Schedule J, Part I, line 11)	31	
32	Reserved for future use	32	
33	Total payments and credits (Schedule J, Part III, line 23)	33	
34	Estimated tax penalty. See instructions. Check if Form 2220 is attached ▶ ☐	34	
35	**Amount owed.** If line 33 is smaller than the total of lines 31 and 34, enter amount owed	35	
36	**Overpayment.** If line 33 is larger than the total of lines 31 and 34, enter amount overpaid	36	
37	Enter amount from line 36 you want: **Credited to 2022 estimated tax** ▶ **Refunded** ▶	37	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer | Date | Title

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11450Q Form **1120** (2021)

IRS Form 1120-S for an S Corporation

- Page 1 of 5

Form **1120-S** | **U.S. Income Tax Return for an S Corporation** | OMB No. 1545-0123

Department of the Treasury
Internal Revenue Service

▶ Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.
▶ Go to *www.irs.gov/Form1120S* for instructions and the latest information.

2021

For calendar year 2021 or tax year beginning , 2021, ending , 20

	TYPE OR PRINT	
A S election effective date	Name	D Employer identification number
B Business activity code number (see instructions)	Number, street, and room or suite no. If a P.O. box, see instructions.	E Date incorporated
C Check if Sch. M-3 attached ☐	City or town, state or province, country, and ZIP or foreign postal code	F Total assets (see instructions) $

G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. ☐ Yes ☐ No

H Check if: **(1)** ☐ Final return **(2)** ☐ Name change **(3)** ☐ Address change **(4)** ☐ Amended return **(5)** ☐ S election termination

I Enter the number of shareholders who were shareholders during any part of the tax year ▶

J Check if corporation: **(1)** ☐ Aggregated activities for section 465 at-risk purposes **(2)** ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 21. See the instructions for more information.

Income	1a	Gross receipts or sales	1a	
	b	Returns and allowances	1b	
	c	Balance. Subtract line 1b from line 1a		1c
	2	Cost of goods sold (attach Form 1125-A)		2
	3	Gross profit. Subtract line 2 from line 1c		3
	4	Net gain (loss) from Form 4797, line 17 (attach Form 4797)		4
	5	Other income (loss) (see instructions—attach statement)		5
	6	**Total income (loss).** Add lines 3 through 5 ▶		6
Deductions (see instructions for limitations)	7	Compensation of officers (see instructions—attach Form 1125-E)		7
	8	Salaries and wages (less employment credits)		8
	9	Repairs and maintenance		9
	10	Bad debts		10
	11	Rents		11
	12	Taxes and licenses		12
	13	Interest (see instructions)		13
	14	Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562)		14
	15	Depletion **(Do not deduct oil and gas depletion.)**		15
	16	Advertising		16
	17	Pension, profit-sharing, etc., plans		17
	18	Employee benefit programs		18
	19	Other deductions (attach statement)		19
	20	**Total deductions.** Add lines 7 through 19 ▶		20
	21	**Ordinary business income (loss).** Subtract line 20 from line 6		21
Tax and Payments	22a	Excess net passive income or LIFO recapture tax (see instructions)	22a	
	b	Tax from Schedule D (Form 1120-S)	22b	
	c	Add lines 22a and 22b (see instructions for additional taxes)		22c
	23a	2021 estimated tax payments and 2020 overpayment credited to 2021	23a	
	b	Tax deposited with Form 7004	23b	
	c	Credit for federal tax paid on fuels (attach Form 4136)	23c	
	d	Add lines 23a through 23c		23d
	24	Estimated tax penalty (see instructions). Check if Form 2220 is attached ▶ ☐		24
	25	**Amount owed.** If line 23d is smaller than the total of lines 22c and 24, enter amount owed		25
	26	**Overpayment.** If line 23d is larger than the total of lines 22c and 24, enter amount overpaid		26
	27	Enter amount from line 26: **Credited to 2022 estimated tax ▶** **Refunded ▶**		27

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of officer | Date | ▶ Title

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11510H Form **1120-S** (2021)

IRS Form 1065 for Partnerships

- Page 1 of 5

Form **1065** | **U.S. Return of Partnership Income** | OMB No. 1545-0123

Department of the Treasury Internal Revenue Service

For calendar year 2021, or tax year beginning ____________, 2021, ending ____________, 20____.

► Go to *www.irs.gov/Form1065* for instructions and the latest information.

2021

A Principal business activity	Type or Print	Name of partnership	D Employer identification number
B Principal product or service		Number, street, and room or suite no. If a P.O. box, see instructions.	E Date business started
C Business code number		City or town, state or province, country, and ZIP or foreign postal code	F Total assets (see instructions) $

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

H Check accounting method: (1) ☐ Cash (2) ☐ Accrual (3) ☐ Other (specify) ►

I Number of Schedules K-1. Attach one for each person who was a partner at any time during the tax year ►

J Check if Schedules C and M-3 are attached ► ☐

K Check if partnership: (1) ☐ Aggregated activities for section 465 at-risk purposes (2) ☐ Grouped activities for section 469 passive activity purposes

Caution: Include **only** trade or business income and expenses on lines 1a through 22 below. See instructions for more information.

Income	1a	Gross receipts or sales (1a)	
	b	Returns and allowances (1b)	
	c	Balance. Subtract line 1b from line 1a	1c
	2	Cost of goods sold (attach Form 1125-A)	2
	3	Gross profit. Subtract line 2 from line 1c	3
	4	Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)	4
	5	Net farm profit (loss) (attach Schedule F (Form 1040))	5
	6	Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797)	6
	7	Other income (loss) (attach statement)	7
	8	**Total income (loss).** Combine lines 3 through 7	8
Deductions (see instructions for limitations)	9	Salaries and wages (other than to partners) (less employment credits)	9
	10	Guaranteed payments to partners	10
	11	Repairs and maintenance	11
	12	Bad debts	12
	13	Rent	13
	14	Taxes and licenses	14
	15	Interest (see instructions)	15
	16a	Depreciation (if required, attach Form 4562) (16a)	
	b	Less depreciation reported on Form 1125-A and elsewhere on return (16b)	16c
	17	Depletion **(Do not deduct oil and gas depletion.)**	17
	18	Retirement plans, etc.	18
	19	Employee benefit programs	19
	20	Other deductions (attach statement)	20
	21	**Total deductions.** Add the amounts shown in the far right column for lines 9 through 20	21
	22	**Ordinary business income (loss).** Subtract line 21 from line 8	22
Tax and Payment	23	Interest due under the look-back method—completed long-term contracts (attach Form 8697)	23
	24	Interest due under the look-back method—income forecast method (attach Form 8866)	24
	25	BBA AAR imputed underpayment (see instructions)	25
	26	Other taxes (see instructions)	26
	27	**Total balance due.** Add lines 23 through 26	27
	28	Payment (see instructions)	28
	29	**Amount owed.** If line 28 is smaller than line 27, enter amount owed	29
	30	**Overpayment.** If line 28 is larger than line 27, enter overpayment	30

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than partner or limited liability company member) is based on all information of which preparer has any knowledge.

► Signature of partner or limited liability company member ► Date

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ►			Firm's EIN ►	
Firm's address ►			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11390Z Form **1065** (2021)

IRS Form 1040 Schedule C for Individuals

- Page 1 of 2

SCHEDULE C (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Profit or Loss From Business

(Sole Proprietorship)

► Go to *www.irs.gov/ScheduleC* for instructions and the latest information.

► Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships must generally file Form 1065.

OMB No. 1545-0074

2021

Attachment Sequence No. **09**

Name of proprietor | Social security number (SSN)

A Principal business or profession, including product or service (see instructions) | **B Enter code from instructions** ►

C Business name. If no separate business name, leave blank. | **D Employer ID number (EIN)** (see instr.)

E Business address (including suite or room no.) ►

City, town or post office, state, and ZIP code

F Accounting method: (1) Cash (2) Accrual (3) Other (specify) ►

G Did you "materially participate" in the operation of this business during 2021? If "No," see instructions for limit on losses . . Yes No

H If you started or acquired this business during 2021, check here . . . ►

I Did you make any payments in 2021 that would require you to file Form(s) 1099? See instructions . . Yes No

J If "Yes," did you or will you file required Form(s) 1099? . . Yes No

Part I Income

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked . . . ►	1
2	Returns and allowances	2
3	Subtract line 2 from line 1	3
4	Cost of goods sold (from line 42)	4
5	**Gross profit.** Subtract line 4 from line 3	5
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6
7	**Gross income.** Add lines 5 and 6 . . . ►	7

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8	18	Office expense (see instructions)	18
9	Car and truck expenses (see instructions)	9	19	Pension and profit-sharing plans	19
			20	Rent or lease (see instructions):	
10	Commissions and fees	10	a	Vehicles, machinery, and equipment	20a
11	Contract labor (see instructions)	11	b	Other business property	20b
12	Depletion	12	21	Repairs and maintenance	21
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13	22	Supplies (not included in Part III)	22
			23	Taxes and licenses	23
			24	Travel and meals:	
14	Employee benefit programs (other than on line 19)	14	a	Travel	24a
15	Insurance (other than health)	15	b	Deductible meals (see instructions)	24b
16	Interest (see instructions):		25	Utilities	25
a	Mortgage (paid to banks, etc.)	16a	26	Wages (less employment credits)	26
b	Other	16b	27a	Other expenses (from line 48)	27a
17	Legal and professional services	17	b	**Reserved for future use**	27b

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27a . . . ►	28
29	Tentative profit or (loss). Subtract line 28 from line 7	29
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. **Simplified method filers only:** Enter the total square footage of (a) your home: ______ and (b) the part of your home used for business: ______ . Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see instructions). Estates and trusts, enter on **Form 1041, line 3.** • If a loss, you **must** go to line 32.	31
32	If you have a loss, check the box that describes your investment in this activity. See instructions. • If you checked 32a, enter the loss on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see the line 31 instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If you checked 32b, you **must** attach **Form 6198.** Your loss may be limited.	32a All investment is at risk. 32b Some investment is not at risk.

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11334P **Schedule C (Form 1040) 2021**

IRS Form 1040 Schedule E for Individuals

- Page 1 of 2

SCHEDULE E (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Supplemental Income and Loss
(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041.
▶ Go to *www.irs.gov/ScheduleE* for instructions and the latest information.

OMB No. 1545-0074
2021
Attachment Sequence No. **13**

Name(s) shown on return | Your social security number

Part I **Income or Loss From Rental Real Estate and Royalties** **Note:** If you are in the business of renting personal property, use **Schedule C**. See instructions. If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

A Did you make any payments in 2021 that would require you to file Form(s) 1099? See instructions . . . . . ☐ **Yes** ☐ **No**
B If "Yes," did you or will you file required Form(s) 1099? . . . . . ☐ **Yes** ☐ **No**

1a	Physical address of each property (street, city, state, ZIP code)
A	
B	
C	

1b	Type of Property (from list below)	2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the **QJV** box only if you meet the requirements to file as a qualified joint venture. See instructions.		Fair Rental Days	Personal Use Days	QJV
A			A			☐
B			B			☐
C			C			☐

Type of Property:
1 Single Family Residence
2 Multi-Family Residence
3 Vacation/Short-Term Rental
4 Commercial
5 Land
6 Royalties
7 Self-Rental
8 Other (describe)

Income:	**Properties:**		A	B	C
3	Rents received	3			
4	Royalties received	4			
Expenses:					
5	Advertising	5			
6	Auto and travel (see instructions)	6			
7	Cleaning and maintenance	7			
8	Commissions.	8			
9	Insurance	9			
10	Legal and other professional fees	10			
11	Management fees	11			
12	Mortgage interest paid to banks, etc. (see instructions)	12			
13	Other interest.	13			
14	Repairs.	14			
15	Supplies	15			
16	Taxes	16			
17	Utilities	17			
18	Depreciation expense or depletion	18			
19	Other (list) ▶	19			
20	Total expenses. Add lines 5 through 19	20			
21	Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198**	21			
22	Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions)	22	( )	( )	( )

23a	Total of all amounts reported on line 3 for all rental properties	23a	
b	Total of all amounts reported on line 4 for all royalty properties	23b	
c	Total of all amounts reported on line 12 for all properties	23c	
d	Total of all amounts reported on line 18 for all properties	23d	
e	Total of all amounts reported on line 20 for all properties	23e	
24	**Income.** Add positive amounts shown on line 21. **Do not** include any losses	24	
25	**Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here .	25	( )
26	**Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040), line 5. Otherwise, include this amount in the total on line 41 on page 2 .	26	

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11344L **Schedule E (Form 1040) 2021**

IRS Form 1065 Schedule K-1

- Page 1 of 1

651121

Final K-1 | Amended K-1 | OMB No. 1545-0123

Schedule K-1 (Form 1065) **2021**
Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year
beginning / / 2021 ending / /

Partner's Share of Income, Deductions, Credits, etc. ▶ See back of form and separate instructions.

Part I Information About the Partnership

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS center where partnership filed return ▶

D Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.)

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.

G General partner or LLC member-manager | Limited partner or other LLC member

H1 Domestic partner | Foreign partner

H2 If the partner is a disregarded entity (DE), enter the partner's:
TIN Name

I1 What type of entity is this partner?

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ▶

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

Check if decrease is due to sale or exchange of partnership interest ▶

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$	$

Check this box if Item K includes liability amounts from lower tier partnerships ▶

L **Partner's Capital Account Analysis**

Beginning capital account	$
Capital contributed during the year	$
Current year net income (loss)	$
Other increase (decrease) (attach explanation)	$
Withdrawals and distributions	$ ( )
Ending capital account	$

M Did the partner contribute property with a built-in gain (loss)?
Yes No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning $
Ending $

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1 Ordinary business income (loss)
2 Net rental real estate income (loss)
3 Other net rental income (loss)
4a Guaranteed payments for services
4b Guaranteed payments for capital
4c Total guaranteed payments
5 Interest income
6a Ordinary dividends
6b Qualified dividends
6c Dividend equivalents
7 Royalties
8 Net short-term capital gain (loss)
9a Net long-term capital gain (loss)
9b Collectibles (28%) gain (loss)
9c Unrecaptured section 1250 gain
10 Net section 1231 gain (loss)
11 Other income (loss)
12 Section 179 deduction
13 Other deductions
14 Self-employment earnings (loss)
15 Credits
16 Schedule K-3 is attached if checked ▶
17 Alternative minimum tax (AMT) items
18 Tax-exempt income and nondeductible expenses
19 Distributions
20 Other information
21 Foreign taxes paid or accrued
22 More than one activity for at-risk purposes*
23 More than one activity for passive activity purposes*

*See attached statement for additional information.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1065. www.irs.gov/Form1065 Cat. No. 11394R Schedule K-1 (Form 1065) 2021

IRS Form 1120-S Schedule K-1

- Page 1 of 1

671121

☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0123

Schedule K-1 (Form 1120-S) **2021**

Department of the Treasury
Internal Revenue Service

For calendar year 2021, or tax year

beginning / / 2021 ending / /

Shareholder's Share of Income, Deductions, Credits, etc. ▶ See separate instructions.

Part I Information About the Corporation

A Corporation's employer identification number

B Corporation's name, address, city, state, and ZIP code

C IRS Center where corporation filed return

D Corporation's total number of shares
Beginning of tax year
End of tax year

Part II Information About the Shareholder

E Shareholder's identifying number

F Shareholder's name, address, city, state, and ZIP code

G Current year allocation percentage %

H Shareholder's number of shares
Beginning of tax year
End of tax year

I Loans from shareholder
Beginning of tax year $
End of tax year $

For IRS Use Only

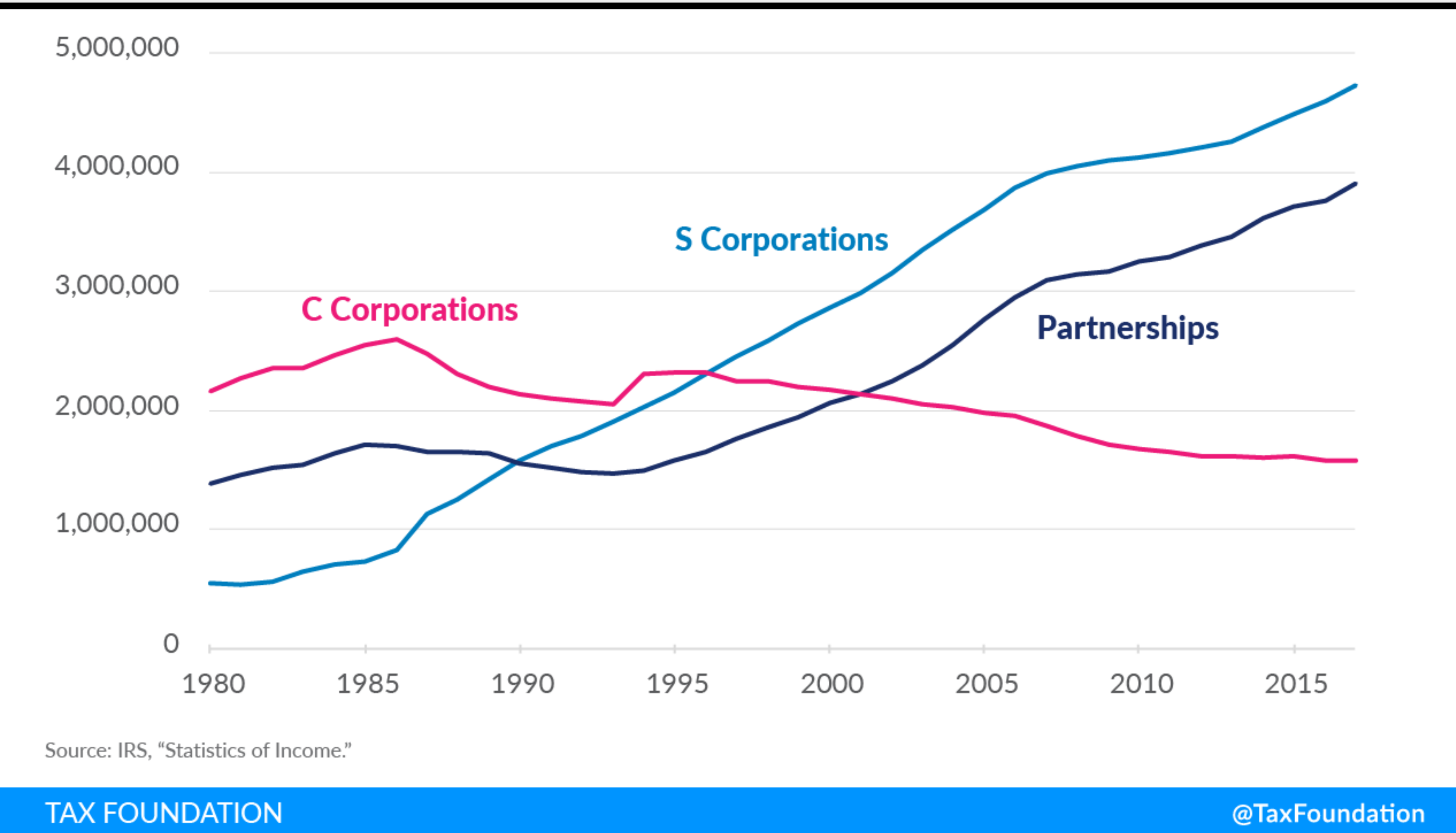
Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items

1 Ordinary business income (loss)
2 Net rental real estate income (loss)
3 Other net rental income (loss)
4 Interest income
5a Ordinary dividends
5b Qualified dividends
6 Royalties
7 Net short-term capital gain (loss)
8a Net long-term capital gain (loss)
8b Collectibles (28%) gain (loss)
8c Unrecaptured section 1250 gain
9 Net section 1231 gain (loss)
10 Other income (loss)
11 Section 179 deduction
12 Other deductions
13 Credits
14 Schedule K-3 is attached if checked ▶ ☐
15 Alternative minimum tax (AMT) items
16 Items affecting shareholder basis
17 Other information
18 ☐ More than one activity for at-risk purposes*
19 ☐ More than one activity for passive activity purposes*

* See attached statement for additional information.

For Paperwork Reduction Act Notice, see the Instructions for Form 1120-S. www.irs.gov/Form1120S Cat. No. 11520D Schedule K-1 (Form 1120-S) 2021

Number of Firms by Entity Type, 1980 to 2017



Corporations Generally

- Both C corporations and S corporations are “corporations” under the Internal Revenue Code for federal income tax purposes.
- A corporation is a legal entity separate from its shareholders that exists perpetually until it is dissolved.
- The risk to the shareholder is limited to the risk of losing their investment. Corporate shareholders are not personally liable for the debts of the corporation.
- The shareholder’s ownership interest in the corporation is represented by freely transferrable shares.
- Corporations are managed by a board of directors that are elected by the shareholders. The board of directors appoints the corporation’s officers.

Corporate Formation: Nonrecognition Under IRC § 351

- Contributions to a corporation are tax-free only if they meet the 80% of control test set forth under Internal Revenue Code Section 351.
- This test requires that the contributors own at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of stock immediately after the contribution.

Taxation of C Corporations

- C corporations are taxed under a firm-taxation, also known as "double taxation," model:
  - The corporation is taxed on its income.
  - Shareholders are taxed separately on any distributions that they receive.
- Because the C corporation is considered an entity separate from its shareholders, the C corporation must compute its own annual gross income and deductions, pay corporate taxes, and file its own annual return (Form 1120).

Taxation of C Corporations

- Under certain circumstances, if a C corporation accumulates its earnings, it may be subject to penalty taxes in addition to corporate income taxes.

Historic U.S. Corporate Tax Rates

Year	Max Tax Rate	President	Comments
1909	1	Taft	
1916	2	Wilson	Reduced tariffs and raised corporate
1917	6		U .S. entered WWI
1918	12		Taxes raised to finance WWI
1919	10		WWI ended
1922	12.5	Harding	Lowered income tax and raised corporate
1925	13	Coolidge	Reduced income tax, raised corporate
1926	13.5		Recession
1928	12		Recession ended
1929	11	Hoover	Tax cut triggered stock market crash
1930	12		Dust Bowl started
1932	13.8		Tax hikes to stop speculation worsened depression.
1936	15	FDR	Hike revived depression
1938	19		Dust Bowl ended
1940	24		Hike to finance WWII
1941	31		Pearl Harbor
1942	40		Hikes to pay for WWII
1950	38	Truman	Cut to fight recession
1951	50.75		Hike to fund Korean War
1952	52	Eisenhower	No cuts, despite 1953 and 1957 recessions.
1964	50	LBJ	Implemented JFK's tax cut
1965	48		Cut boosted economy
1968	52.8		Hikes paid for Great Society and Vietnam War
1970	49.2	Nixon	Recession
1971	48		Cut to fight recession
1979	46	Carter	Cut to offset high interest rates
1987	40	Reagan	Tax Reform Act
1988	34		Cut to fight recession.
1993	35	Clinton	Omnibus Budget Reconciliation Act
2018	21	Trump	Tax Act goes into effect

Source: IRS; Table: The Balance, https://www.thebalance.com/corporate-income-tax-definition-history-effective-rate-3306024

Fringe Benefits

- Fringe benefits are benefits offered by an employer to their employees in addition to wages and salaries.
- Some fringe benefits are taxable, while others are not.
- Tax advantaged C corporation fringe benefit plans, as used in the Internal Revenue Code, include:
  - Group-term life insurance purchased for employees
  - Amounts received under accident and health plans
  - Contributions by employer to accident and health plans
  - Cafeteria plans
  - Educational assistance programs
  - Dependent care assistance programs
  - Adoption assistance programs

C Corp v. S Corp Fringe Benefits

- Some fringe benefits provided by C corporations are not considered compensation. The employees are therefore not taxed on the value of those benefits.
- Unlike C corporations, however, S corporations are treated like partnerships for fringe benefit purposes. IRC 1372. Any 2% S corporation shareholder is treated as a partner.

IRC § 1372 - Partnership rules to apply for fringe benefit purposes

(a)GENERAL RULE

For purposes of applying the provisions of this subtitle which relate to employee fringe benefits—

(1)the S corporation shall be treated as a partnership, and

(2)any 2-percent shareholder of the S corporation shall be treated as a partner of such partnership.

(b)2-PERCENT SHAREHOLDER DEFINED

For purposes of this section, the term “2-percent shareholder” means any person who owns (or is considered as owning within the meaning of section 318) on any day during the taxable year of the S corporation more than 2 percent of the outstanding stock of such corporation or stock possessing more than 2 percent of the total combined voting power of all stock of such corporation.

Health Insurance Non-Discrimination Rules

- Is a C corporation permitted to provide health insurance to some employees but not others (for example: an executive but not the executive's secretary)?
  - Yes, unless the health insurance qualifies as a "self-insured medical reimbursement plan."
  - IRC 105(h)(6) defines "self-insured medical reimbursement plan" as, "a plan of an employer to reimburse employees for [medical] expenses . . . for which reimbursement is not provided under a policy of accident and health insurance."
  - If the plan qualifies as a "self-insured medical reimbursement plan" and certain non-discrimination rules are not met (I.R.C. § 105(h)(3)(A)), highly compensated individuals must include "excessive reimbursements" as gross income.

Vehicles

- If a corporation provides a vehicle to an employee to use, the employee’s use of the vehicle may qualify as a fringe benefit to that employee.
- Under IRC 132, however, the value of the employee’s business use of the vehicle is excluded from the employee’s gross income.
- The value of the employee’s personal use of the vehicle is a compensation expense to the employer.

The Guzzler Award

The following vehicles are among those that qualify for a 80% write-off upon acquisition under certain circumstances/over 6,000 pounds:

- Audi Q7
- BMW X5, X6
- Buick Enclave
- Cadillac XT5, XT6, Escalade
- Chevrolet Silverado, Suburban, Tahoe, Traverse
- Chrysler Pacifica
- Dodge Durango, Grand Caravan
- Ford Expedition, Explorer, F-150 and larger
- GMC Acadia, Sierra, Yukon
- Honda Pilot 4WD, Odyssey
- Infiniti QX80, QX56
- Jeep Grand Cherokee
- Land Rover Range Rover, Discovery
- Lexus GX460, LX570
- Lincoln MKT AWD, Navigator
- Mercedes-Benz G550, GLS, GLE, Metris, Sprinter
- Nissan Armada, NV 1500, NVP 3500, Titan
- Porsche Cayenne
- Tesla Model X
- Toyota 4Runner, Landcruiser, Sequoia, Tundra

Consolidated Groups

- Affiliated Group: At least 80% of the stock of Corporation A is owned by Corporation B
- Corporations in an affiliated group can file a consolidated tax return.
- Any transactions between members of the consolidated group will be canceled out on the return.
  - Intercorporate sales of goods/services
  - Offset losses

Consolidated Groups

- If Corporation A's stock is then acquired by Corporation C from Corporation B, the acquiring Corporation C is able to make an election under IRC 338 that steps up the basis of Corporation A's assets.
- The IRC 338 election is considered a sale of A's assets. The sale is taxable to Corporation A. This tax will not be paid on the consolidated return but on A's separate tax return.
- IRC 338 then allows Corporation C to take gain on the sale as income. The basis of Corporation C's stock in Corporation A is then stepped up by the amount of the gain.

Consolidated Groups

- Essentially, the 338(h)(10) election operates as though Corporation A was liquidated and its assets were sold by Corporation C.
- **IRC 338(h)(10) ELECTIVE RECOGNITION OF GAIN OR LOSS BY TARGET CORPORATION, TOGETHER WITH NONRECOGNITION OF GAIN OR LOSS ON STOCK SOLD BY SELLING CONSOLIDATED GROUP**
  - **(A)In general:** Under regulations prescribed by the Secretary, an election may be made under which if—
    - **(i)**the target corporation was, before the transaction, a member of the selling consolidated group, and
    - **(ii)**the target corporation recognizes gain or loss with respect to the transaction as if it sold all of its assets in a single transaction,
  - then the target corporation shall be treated as a member of the selling consolidated group with respect to such sale, and (to the extent provided in regulations) no gain or loss will be recognized on stock sold or exchanged in the transaction by members of the selling consolidated group.

Section 1202 Corporations

- Section 1202 of the Code permits the shareholder of a qualifying C corporation that meets certain requirements to sell stock held for more than five years without paying capital gains tax on the sale.
- A shareholder who has held Section 1202 qualifying stock for less than five years can reinvest the monies received from the sale of such stock to buy other Section 1202 qualifying stock on a tax-deferred basis. The holding period will be tacked to the holding period of the previously held Section 1202 stock, so that the sale of the subsequently acquired Section 1202 stock can be tax-free after a five-year combined holding period if the requirements discussed below are met.
- There are many requirements that must be satisfied to qualify for Section 1202 status. These include having the company engaged in an active trade or business that is not one of the "Specified Service Trades or Businesses" enumerated in the Statute and having at least 80% of the corporate assets being used or needed in the business or businesses of the company.
- A Section 1202 company may perform management, marketing, billing, or associated services for a related entity, and may invest its profits in one or more other businesses. Another aspect of Section 1202 planning is that the liquidation of the company or distribution of assets to the shareholders after five years will still be subject to tax. The only way to avoid the tax is to sell the ownership of the company.

Section 1202 companies are not permitted to engage in the following trades or businesses:

1. Health,
2. Law,
3. Accounting,
4. Actuarial science,
5. Performing Arts,
6. Consulting,
7. Athletics,
8. Financial Services,
9. Brokerage Services,
10. Investing, Trading, or Dealing in Securities, Partnership Interest, or Commodities,
11. Any business where the principal asset is the reputation or skill of one or more of its employees,
12. Engineering,
13. Architecture,
14. Oil and Gas,
15. Hotels and motels,
16. Restaurants,
17. Businesses similar to hotels, motels or restaurants.

General Requirements to Qualify for Section 1202 Gain Exclusion

1. Must be stock of a C corporation acquired after 1993.
2. Stock must have been acquired at original issue in exchange for money or other property, or as compensation for services performed for the corporation.
3. The Corporation must be a "qualified small business" immediately before and immediately after the issuance of stock.
4. During substantially all of the taxpayer's holding period, the Corporation meets the active trade or business requirements of Section 1202(e).
5. The qualifying stock must be held for more than five years.

Taxation of S Corporations

- Subchapter S of the Internal Revenue Code permits qualifying corporations to elect to be taxed under a flow-through taxation model:
  - The S corporation is not taxed. (Exception: Under certain circumstances, an S corporation that was previously a C corporation will be taxed on earnings and profits from when it was a C corporation.)
  - The corporation's income, expenses, gains, and losses "flow-through" to the shareholders when it is earned by the S corporation, regardless of whether any distributions are made to the shareholders.

IRC § 1374 Unrecognized Built-In Gain Rules

- If a C corporation converts to a S corporation, all of the C corporation's "hot" assets (those with unrecognized built-in gain) will be taxed at the corporate level if they are disposed of within 5 years of making the § 1374 election.

IRC Section 1374

(a)General rule

If for any taxable year beginning in the recognition period an S corporation has a net recognized built-in gain, there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation for such taxable year.

(b)Amount of tax(1)In general

The amount of the tax imposed by subsection (a) shall be computed by applying the highest rate of tax specified in section 11(b) to the net recognized built-in gain of the S corporation for the taxable year.

(2)Net operating loss carryforwards from C years allowed

Notwithstanding section 1371(b)(1), any net operating loss carryforward arising in a taxable year for which the corporation was a C corporation shall be allowed for purposes of this section as a deduction against the net recognized built-in gain of the S corporation for the taxable year. For purposes of determining the amount of any such loss which may be carried to subsequent taxable years, the amount of the net recognized built-in gain shall be treated as taxable income. Rules similar to the rules of the preceding sentences of this paragraph shall apply in the case of a capital loss carryforward arising in a taxable year for which the corporation was a C corporation.

(3)Credits

(A)In general

Except as provided in subparagraph (B), no credit shall be allowable under part IV of subchapter A of this chapter (other than under section 34) against the tax imposed by subsection (a).

(B)Business credit carryforwards from C years allowed

Notwithstanding section 1371(b)(1), any business credit carryforward under section 39 arising in a taxable year for which the corporation was a C corporation shall be allowed as a credit against the tax imposed by subsection (a) in the same manner as if it were imposed by section 11.

(c)Limitations

(1)Corporations which were always S corporations

Subsection (a) shall not apply to any corporation if an election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years. Except as provided in regulations, an S corporation and any predecessor corporation shall be treated as 1 corporation for purposes of the preceding sentence.

(2)Limitation on amount of net recognized built-in gain

The amount of the net recognized built-in gain taken into account under this section for any taxable year shall not exceed the excess (if any) of—

(A)the net unrealized built-in gain, over

(B)the net recognized built-in gain for prior taxable years beginning in the recognition period.

(d)Definitions and special rules

For purposes of this section—

(1)Net unrealized built-in gain

The term "net unrealized built-in gain" means the amount (if any) by which—

(A)the fair market value of the assets of the S corporation as of the beginning of its 1st taxable year for which an election under section 1362(a) is in effect, exceeds

(B)the aggregate adjusted bases of such assets at such time.

(2)Net recognized built-in gain

(A)In general

The term "net recognized built-in gain" means, with respect to any taxable year in the recognition period, the lesser of—

(i)the amount which would be the taxable income of the S corporation for such taxable year if only recognized built-in gains and recognized built-in losses were taken into account, or

(ii)such corporation's taxable income for such taxable year (determined as provided in section 1375(b)(1)(B)).

(B)Carryover

If, for any taxable year described in subparagraph (A), the amount referred to in clause (i) of subparagraph (A) exceeds the amount referred to in clause (ii) of subparagraph (A), such excess shall be treated as a recognized built-in gain in the succeeding taxable year.

(3)Recognized built-in gain

The term "recognized built-in gain" means any gain recognized during the recognition period on the disposition of any asset except to the extent that the S corporation establishes that—

(A)such asset was not held by the S corporation as of the beginning of the 1st taxable year for which it was an S corporation, or

(B)such gain exceeds the excess (if any) of—

(i)the fair market value of such asset as of the beginning of such 1st taxable year, over

(ii)the adjusted basis of the asset as of such time.

(4)Recognized built-in losses

The term "recognized built-in loss" means any loss recognized during the recognition period on the disposition of any asset to the extent that the S corporation establishes that—

(A)such asset was held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (3), and

(B)such loss does not exceed the excess of—

(i)the adjusted basis of such asset as of the beginning of such 1st taxable year, over

(ii)the fair market value of such asset as of such time.

(5)Treatment of certain built-in items

(A)Income items

Any item of income which is properly taken into account during the recognition period but which is attributable to periods before the 1st taxable year for which the corporation was an S corporation shall be treated as a recognized built-in gain for the taxable year in which it is properly taken into account.

(B)Deduction items

Any amount which is allowable as a deduction during the recognition period (determined without regard to any carryover) but which is attributable to periods before the 1st taxable year referred to in subparagraph (A) shall be treated as a recognized built-in loss for the taxable year for which it is allowable as a deduction.

(C)Adjustment to net unrealized built-in gain

The amount of the net unrealized built-in gain shall be properly adjusted for amounts which would be treated as recognized built-in gains or losses under this paragraph if such amounts were properly taken into account (or allowable as a deduction) during the recognition period.

(6)Treatment of certain property

If the adjusted basis of any asset is determined (in whole or in part) by reference to the adjusted basis of any other asset held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (3)—

(A)such asset shall be treated as held by the S corporation as of the beginning of such 1st taxable year, and

(B)any determination under paragraph (3)(B) or (4)(B) with respect to such asset shall be made by reference to the fair market value and adjusted basis of such other asset as of the beginning of such 1st taxable year.

(7)Recognition period

(A)In general

The term "recognition period" means the 5-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation. For purposes of applying this section to any amount includible in income by reason of distributions to shareholders pursuant to section 593(e), the preceding sentence shall be applied without regard to the phrase "5-year".

(B)Installment sales

If an S corporation sells an asset and reports the income from the sale using the installment method under section 453, the treatment of all payments received shall be governed by the provisions of this paragraph applicable to the taxable year in which such sale was made.

(8)Treatment of transfer of assets from C corporation to S corporation

(A)In general

Except to the extent provided in regulations, if—

(i)an S corporation acquires any asset, and

(ii)the S corporation's basis in such asset is determined (in whole or in part) by reference to the basis of such asset (or any other property) in the hands of a C corporation,

then a tax is hereby imposed on any net recognized built-in gain attributable to any such assets for any taxable year beginning in the recognition period. The amount of such tax shall be determined under the rules of this section as modified by subparagraph (B).

(B)Modifications

For purposes of this paragraph, the modifications of this subparagraph are as follows:

(i)In general

The preceding paragraphs of this subsection shall be applied by taking into account the day on which the assets were acquired by the S corporation in lieu of the beginning of the 1st taxable year for which the corporation was an S corporation.

(ii)Subsection (c)

(1) not to apply

Subsection (c)(1) shall not apply.

(9)Reference to 1st taxable year

Any reference in this section to the 1st taxable year for which the corporation was an S corporation shall be treated as a reference to the 1st taxable year for which the corporation was an S corporation pursuant to its most recent election under section 1362.

(e)Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section including regulations providing for the appropriate treatment of successor corporations.

State Income Tax

- C corporations are subject to state income tax on a state-by-state basis.
- Some states impose an income tax on S corporations, but others do not.

Top Marginal Corporate and Individual Income Tax Rates of 10 Most Populous States

State	Corporate Income Tax Rate	Highest Individual Income Tax Rate and Bracket
California	8.84%	13.30% > $1,000,000
Texas	N/A	N/A
Florida	5.50%	N/A
New York	7.25%	10.90% > $25,000,000
Pennsylvania	9.99%	3.07% > $0
Illinois	9.50%	4.95% > $0
Ohio	N/A	3.99% > $110,650
Georgia	5.75%	5.75% > $7,000
North Carolina	2.50%	4.99% > $0
Michigan	6.00%	4.25% > $0

S Corporation Election Requirements

- Requirements to qualify to be taxed as an S corporation:
  - Fewer than 100 shareholders;
  - All shareholders must be individuals (with the exception of certain trusts, disregarded limited liability companies, and tax exempt organizations);
  - Shareholders may not be nonresident aliens;
  - A single class of stock; and
  - Must not have previously made an S corporation election and revoked such election within the last 5 years, unless consent is received from the IRS.
- The election is made by filing Form 2553 with the IRS.

Partnership v. S Corporation
Which is Better to Hold Real Estate?

PARTNERSHIP	**S CORPORATION**
Advantages	*and Disadvantages*
Partners receive basis for indebtedness incurred by the partnership	DOI income insolvency exclusion is determined at the corporate level.
On the death of a partner, the partnership's (inside) tax basis of its assets can receive a step-up in income tax basis, if a Section 754 election is in place for the partnership	No similar basis adjustment mechanism applies to S corporations.
When a new partner buys into a partnership corporation, their depreciation write-off and underlying basis in their partnership interest will be based upon the price that they pay.	When a new shareholder buys into an S corporation, their depreciation write-off and underlying basis if and when the real estate is ever sold has to be based upon the historic basis and depreciation taken, versus being based upon the price they pay.
Appreciated real property can generally be distributed from the partnership tax-free to the partners.	Distributions of appreciated real property to the shareholders are treated as if the property was sold at its fair market value to the shareholders.
No restrictions apply as to who can own partnership interests.	S corporations can only be owned by certain individuals and trusts, and cannot be owned non-resident aliens, corporations or partnerships
Partnerships can have more than one class of stock, and income and distribution preferences can be drafted in virtually any manner, so long as they have substantial economic effect	S corporations cannot have a "second class of stock," and income allocation and distribution rights must be pro rata to ownership
DOI income insolvency exclusion is determined at each partner's level.	Shareholders do not receive basis for indebtedness incurred by the corporate, unless the loan is made by such shareholder.
Have capital accounts for all partners.	Generally, do not have capital accounts for shareholders.

Reasonable Compensation Rules

- S corporations are required to pay reasonable wages to shareholders/owners who render valuable services.
- Form 1120-S, U.S. Income Tax Return for an S Corporation, states, "Distributions and other payments by an S corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation."

S Corporations and C Corporations Compared

Issue/Factor	S Corporation	C Corporation
Tax Rates	Owners are taxed at individual rates for salary and income of the company	Entity taxed for income at 21%; shareholders taxed for dividends and distributions
Double Taxation	Not subject	Dividends or distributions taxed separately
Availability of Section 199A deduction	Available (depending on limitations)	Cannot qualify for Section 199A
Accumulated Earnings	Taxed to owner as reported on their Form K-1, regardless of whether distributions are made	Taxed at 21% corporate rate; beware of accumulated earning tax issues
Guaranteed payments	N/A	N/A

S Corporations and C Corporations Compared

Issue/Factor	S Corporation	C Corporation
Owner provides services (reasonable compensation issues)	W-2 Wages; excluded from QBI and subject to reasonable compensation rules	W-2 Wages; subject to reasonable compensation rules
Business is a Specified Service Trade or Business	Eligible if owner's taxable income is under lower-income thresholds; Limited if in between lower- and higher-income thresholds; Lost if taxable income is greater than higher-income thresholds	N/A
High Income earner as owner	May be limited if Wage/Property Hurdle is not met	N/A

S Corporations and C Corporations Compared

Issue/Factor	S Corporation	C Corporation
Employees (W-2 Wages)	Consider impact on Wage/Property Limitation, adjust if necessary	N/A
Independent contractors	Hurts in application of Wage/Property Hurdle; Compensation not considered W-2 wages	N/A
Qualified property basis	Consider impact on Wage/Property Hurdle, adjust if necessary	N/A
State and local tax deductions	Deduction Limited	Fully Deductible
Medical expenses and plans deductions	N/A	Premiums and medical reimbursement plans are deductible

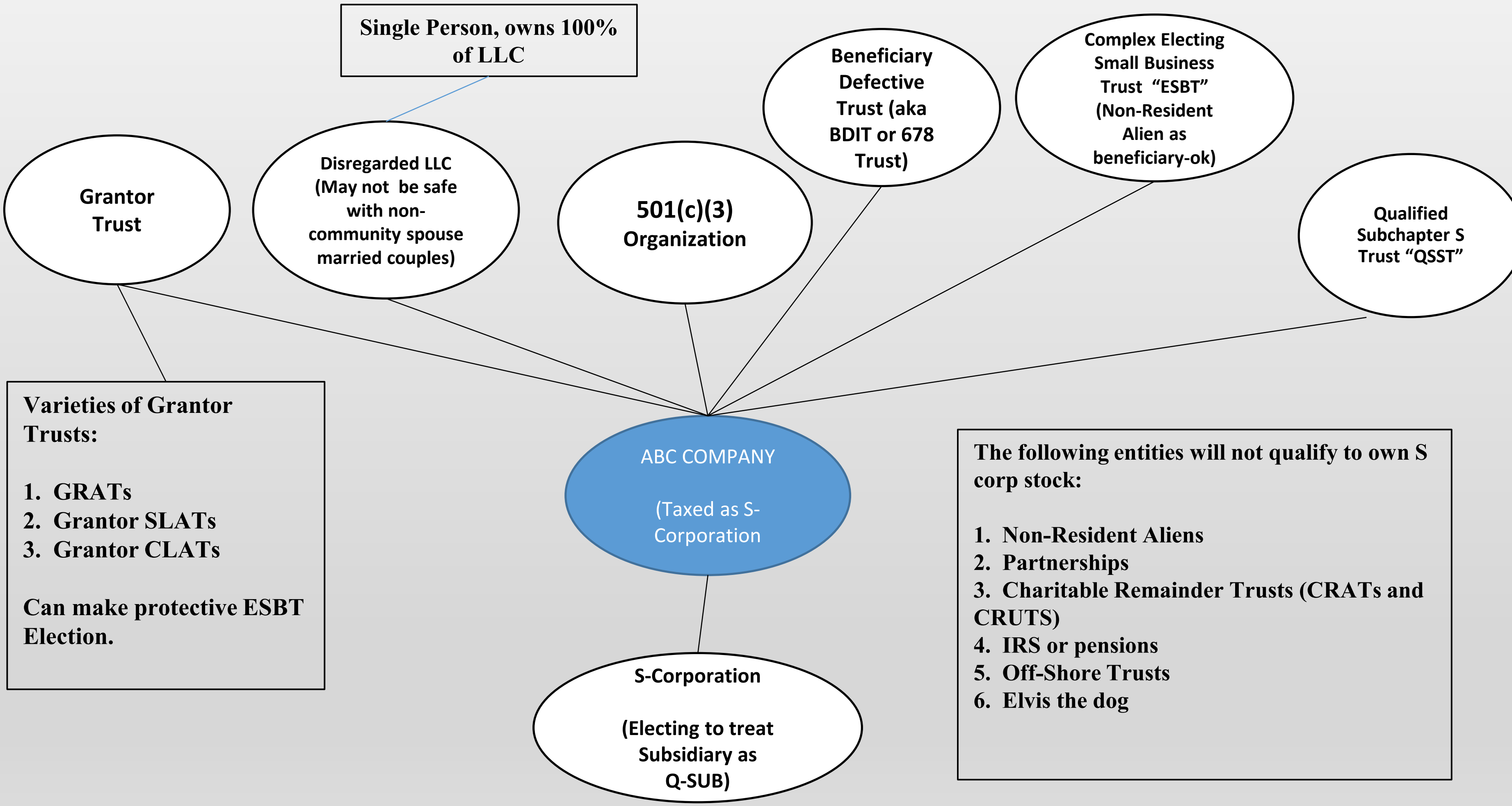
Some Advantages of Partnerships Over S Corporations

- Partnerships do not have the single class of stock requirement, allowing both common and preferred stock.
- Partnerships can have foreign owners.
- When you die, you get a new income tax basis on underlying assets under IRC § 754.

Some Advantages of S Corporations Over Partnerships

- Avoidance of employment taxes and Medicare taxes on net income of the S corporation
- Less complicated than partnerships

Refresher on Types of Entities That Can Hold S-Corporation Stock

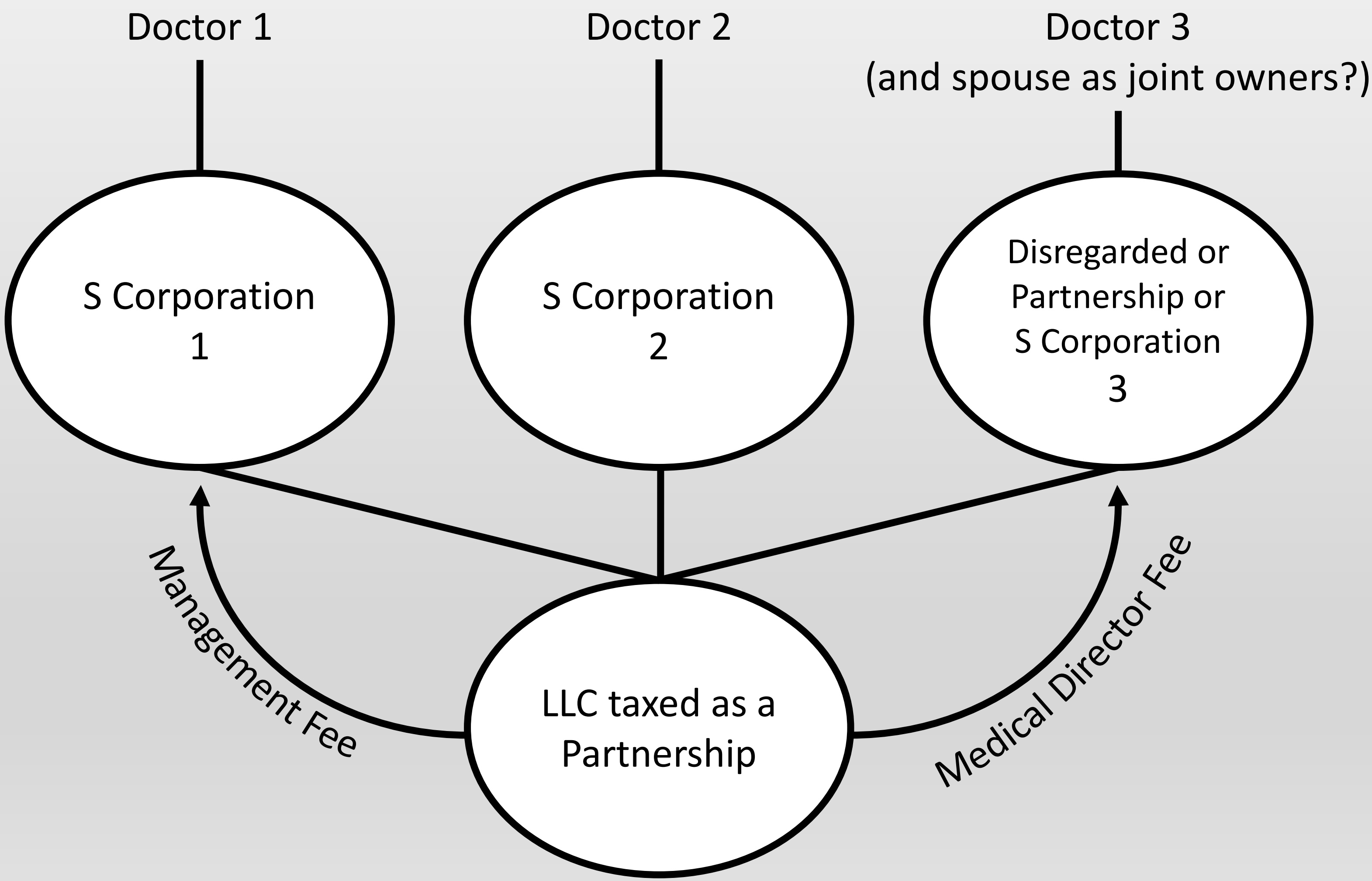


The following entities will not qualify to own S corp stock:

1. Non-Resident Aliens
2. Partnerships
3. Charitable Remainder Trusts (CRATs and CRUTS)
4. IRS or pensions
5. Off-Shore Trusts
6. Elvis the dog

A Partnership of S Corporations

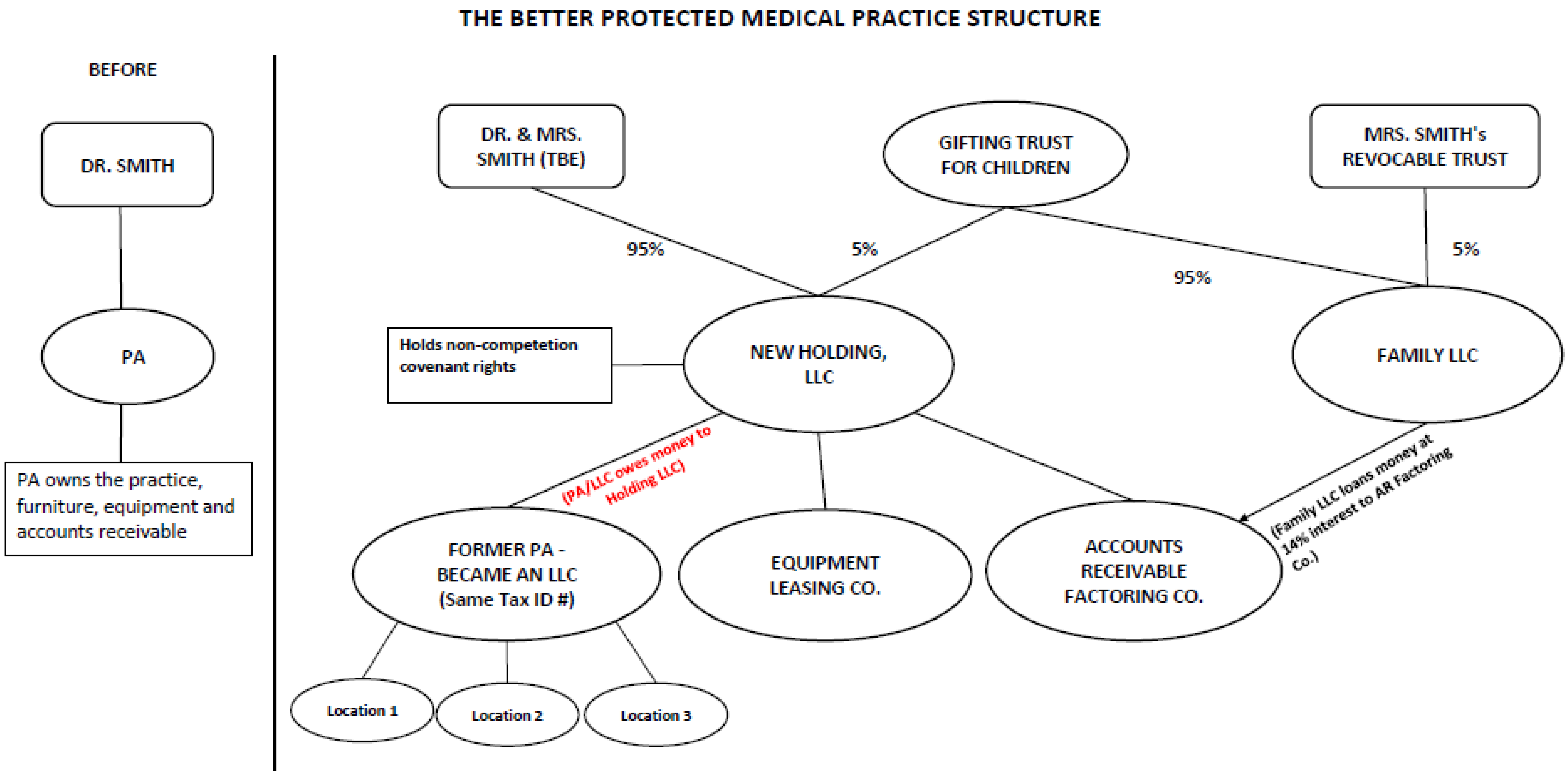
This is a very good way to own a medical practice because each S corp. receives its share of the LLC's profits and each doctor can decide how much comes out of each S corp. as compensation and dividends.



New Parent F Reorganization

- A new S corporation is formed with the same owners as the parent S corporation.
- The parent S corporation can elect for the subsidiary to be treated as a Qualified Subchapter S Subsidiary (QSub) and convey the parent corporation to the new subsidiary corporation in a tax-free transaction.
- Appreciated assets, such as equipment or real estate, can be conveyed from the QSub to the parent or to brother-sister companies without triggering income tax and for creditor protection purposes.

New Parent F Reorganization for a Medical Practice



The Extended Letter of Protection Enhancement System ("ELOPE") © 2007 Gassman, Crotty & Denicolo, P.A.

The Extended Letter of Protection Enhancement (ELOPE) System is a term and technique developed by our firm in 2007 that is especially useful for physicians who do injury victim work and are owed monies under Letters of Protection that are typically significant and are not paid for a number of years.

Many orthopedic surgeons, spine surgeons, and podiatrists have significant "personal injury" medical practices. Oftentimes, these doctors accept Letters of Protection for their services.

A Letter of Protection is a promise that the physician will be paid if and when the personal injury claim is settled. The law firm issuing the Letter of Protection basically agrees that the settlement or jury verdict judgment monies that would otherwise go to the plaintiff/patient will be paid to the doctor, to the extent delineated in the Letter of Protection.

Typically, the Letter of Protection charges are significantly higher than medical insurance, HMOs, or Medicare pay, which takes into account that the doctor has to wait a long time to be paid, and cannot be certain if or when he or she will be paid.

There is, therefore, a significant "Financial Leverage" occurring, as the doctor finances his practice while waiting to be paid sometimes as long as 2-3 years on average.

The Extended Letter of Protection Enhancement System (“ELOPE”)

The ELOPE System is designed to allow affiliated family entities, which may be owned by or for children, grandchildren, and other family members in lower tax brackets, to realize reasonable profits that would otherwise be taxed at the highest bracket possible, while also protecting the Letters of Protection from potential creditors of the medical practice and the physician.

It would make sense to immediately transfer Letters of Protection outside of the medical practice to an affiliated entity, but if the medical practice is taxed as a corporation, whether a regular corporation or an S corporation, the transfer of such Letters of Protection out to the doctor or any other entity affiliated with him or her will normally trigger taxable income on the value of the Letter of Protection at such time.

Therefore, the common idea of having a family limited partnership or other affiliated entity factor or purchase the Letters of Protection from the medical practice is typically not a popular one.

The solution under the ELOPE system is to have a factoring company established as a brother/sister company to the medical practice.

The Extended Letter of Protection Enhancement System (“ELOPE”)

It is simple and inexpensive to establish a “New Parent S Corporation” to own 100% of the stock of the medical practice company and 100% of the stock of the factoring company. This new S corporation can be a Limited Liability Company that might be owned by the physician, the physician’s spouse, or by the physician and the physician’s spouse as Tenants by the Entireties.

The medical practice entity does not need to change its name, its taxpayer identification number, or any other significant aspect of its operations as a result of this “F Reorganization.” Under the tax law it will be known as a Qualified Sub-Chapter S subsidiary (“Q-Sub”).

One business purpose of this arrangement is to allow the affiliated family entity to be reasonably assured that the Letters of Protection that it finances the purchase of will not be lost to a malpractice claimant of the medical practice.

The monies received by the medical practice for the Letters of Protection may be held by the parent company for long term capital needs under an investment account. Unless or until the monies are paid out from the parent company, there should be no income tax thereon. The income from the Letters of Protection will therefore not have to be recognized until the ultimate payor (the patient or the insurance carrier) pays the Factoring Company for the Letter of Protection.

The Extended Letter of Protection Enhancement System (“ELOPE”)

The Factoring Company may be administered by a separate S corporation that might be owned and run by the doctor’s children. In that event, the Factoring Company would pay a reasonable management fee to the management S corporation, then the children might earn sufficient funds to fund their IRAs, and they also receive dividends to the extent that computer systems, policy and procedure manuals, and other physical and intangible assets of the management company cause income to be received.

The purpose accomplished from the point of view of the medical practice company and doctor is that income tax will not be triggered when the Letters of Protection are transferred

to the Factoring Company, because transfers between a brother and sister company that are commonly owned by an S corporation parent can be disregarded for income tax purposes.

NOTE: A subsidiary company can elect to be treated as QSST (Qualified Sub-Chapter S Subsidiary). A new entity may elect to be treated as a Q-Sub or as a disregarded entity L.L.C., but may have a separate tax identification number. Each separate subsidiary should have separate financial statements, bank accounts, and fiscal conduct.

The Extended Letter of Protection Enhancement System ("ELOPE")

All income and deductions of the subsidiaries will go onto a single S corporation tax return for the parent company. However, it is crucial to keep separate books and records for each subsidiary, in order to maintain its independence and to avoid having a creditor of the medical practice assert that the Letter of Protection entity is an "alter ego" or "partner" of the medical practice.

In our example, the Factoring Company would purchase Letters of Protection as they are received by the medical practice. At the end of each calendar month, the Letters of Protection received by the medical practice could be assigned to the Factoring Company, in exchange for which the Factoring Company could give the medical practice cash.

In order to allow an affiliated family entity to provide financial assistance to the medical practice and be paid reasonable compensation for such assistance, the applicable family limited partnership, S corporation, or trust established in whole or in part for the doctor's children, grandchildren, or other family members may have assets that can be pledged or otherwise collateralized to finance the Factoring Company. An example would be a family limited partnership with a $1,000,000 investment portfolio, which borrows money on margin from the brokerage firm at 6.8% interest and advances this money to the subsidiary Factoring Company. The Factoring Company then uses this money to purchase the pre-existing Letters of Protection that the medical practice owns, which may be valued at $400,000, based upon industry standards. The Letters of Protection may have a face amount of $1,000,000.

The Extended Letter of Protection Enhancement System ("ELOPE")

The market value of the Letters of Protection may be established by having arm's-length Factoring Companies review and make offers for the purchase or financing thereof. The Factoring Company can agree to pay a fairly high interest rate to the affiliated family company for the use of the money. The affiliated family company may be paying its broker- age firm 6.8% interest on the margin loan, and it may be receiving 15% interest back from the Factoring Company. Some companies in this industry charge the highest percentage permitted by Florida law, which is 25% when the borrower is a corporation and the loan is in excess of $500,000. Where the loan is under $500,000, the usury rate under Florida Law is 18%. See Florida Statute 687.03.

199A Rules

- **The following slides are taken from a presentation presented by Alan Gassman entitled, "Planning With 199A, 678 Trusts And Complex Trusts." A video recording of the presentation and the complete slide deck is available at https://www.youtube.com/watch?v=lA8owRLPrYo.**

Deduction Is Provided For Qualified Business Income

Qualified business income is "active trade or business income," and must come only from one of the following five places:

1. S corporation K-1 income (includes income from LLCs taxed as S corporations).

2. Partnership K-1 income (includes income from LLCs taxed as partnerships).

3. Trade or Business income reported on Schedule C of a taxpayer's Form 1040 (includes income from single member LLC that is disregarded for income tax purposes).

4. Net rental income reported on Schedule E of Form 1040, from an "active trade or business."

5. Farm income reported on Schedule F of Form 1040.

6. Section 501(c)(3) organizations receiving Unrelated Business Taxable Income ("UBTI") may qualify. IRS indicated in Preamble to Final Regulations that they are continuing to study this issue.

Note - For most taxpayers, K-1 income is cash based, but pension deductions are commonly accrued - you have until December 31st to put new pension plans into place that may be funded next year for 199A and other planning.

Trap for Unwary - Don't make contributions to a SEP-IRA or 401k before determining what plans the client will want for the year – once contributions are made, plans cannot be changed.

Important Definitions You Need To Know

Qualified Business Income ("QBI") – Active trade or business income from flow through entities such as S corporations, entities taxed as partnerships, LLCs, disregarded entities, and Schedule C entities such as sole proprietorships effectively connected to a US trade or business. This does not include monies earned as wages, reasonable compensation, or "guaranteed payments" from entities taxed as partnerships.

Specified Service Trades or Businesses ("SSTB") - Categories of businesses or activities which will not qualify for the flow-through deduction if the individual taxpayer reporting QBI has taxable income exceeding the levels described in slide 10.

Unadjusted Basis Immediately After Acquisition of Qualified Property ("UBIA") – Cost basis of physical assets, including real estate, furniture and equipment owned by a flow-through entity at the end of the taxable year which has not reached the date that is the later of (a) the end of the depreciable life; or (b) ten years from acquisition.

W-2 Wages - Compensation paid to employees of a flow-through entity (including pension contributions and other elective deferrals), which does not include (1) wages earned by an individual taxpayer from sources other than a flow-through entity; (2) compensation paid to independent contractors; or (3) income that is subject to self-employment taxes, if not paid and treated as wages paid to an employee.

Effectively Connected Income – Income that is derived from assets used in or held for use in the US, and the activities of the US business were a material factor in the realization of such income. Puerto Rico based income will also qualify.

Guaranteed Payments – Payments made by a partnership to partners without regard to the partnership's income, which are not considered wages under applicable wage and partnership law.

IRS Notice 2019-7 – Providing the 250 hour safe harbor test for non-triple net lease rental activities to be considered as an active trade or business.

Two Main Rules To Know

(Besides that taxpayers below the threshold can typically take the deduction, most of the time.)

			Situation	Result
1	**Specified Service Trade or Business ("SSTB")**	**A**	Taxpayer's Taxable Income is under $315,000 for Taxpayers married filing jointly, or $157,500 for single filers **($170,050 and $340,100 for 2022)**	**No Limitation applies**
		B	Taxpayer's Taxable Income is between $315,000-$415,000 for Taxpayers married filing jointly or $157,500-$207,500 for single filers	Limitation is phased in by the amount Taxable Income exceeds threshold amount Example – Married with Taxable Income of $365,000. Deduction is equal to 10% of QBI (50% ((365-315)/100) * 20% Deduction.
		C	Taxpayer's Taxable Income exceeds $440,100 for Taxpayers married filing jointly or $220,050 for single filers	**No Deduction**
2	**Wage and Qualified Property Test**	**A**	Taxpayer's Taxable Income is under $340,100 if married filing jointly, or $175,050 for single filers	**No Limitation applies**
		B	Taxpayer's Taxable Income is between $340,100-$440,100 if married filing jointly or $175,050-$220,050 for single filers	Limitation is phased in by the amount Taxable Income exceeds threshold amount
		C	Taxpayer's Taxable Income Exceeds $440,100 if married filing jointly or $220,050 for single filers	Limitation applies unless 50% of Wages, or 25% of Wages plus 2.5% of Qualified Property, are met at the entity level

Items Relating To: Individual Taxpayers Qualified Business Income (Section 199A)

Filing Status	Tax Year 2022	Tax Year 2023	Tax Year 2024
Single	$170,050	$182,100	$191,950
Married Jointly	$340,100	$364,200	$383,900
Head of Household	$170,050	$182,100	$191,950

2024 Phase-out

Married Filing Jointly - $383,900 - 483,900

Single/Head of Household - $191,950 - 241,950

QBI INCREASED BY STANDARD DEDUCTION			
Filing Status	**Tax Year 2022**	**Tax Year 2023**	**Tax Year 2024**
Single	$170,050 + $12,950 = $183,000	$182,100 + $13,850 = $195,950	$191,950 + $14,600 = $206,550
Married Jointly	$340,100 + $25,900 = $366,000	$364,200 + $27,700 = $391,900	$383,900+ $29,200 = $413,100
Head of Household	$170,050+ $19,400 = $189,450	$182,100 + $20,800 = $202,900	$191,950 + $21,900 = $213,850

$206,550 x 7.4% = $15,285

3.8% of $206,550 is $7,849

$15,285 + $7,849 = $23,134

Kiddie Tax And Trust Tax Rates

The Kiddie Tax was modified by the 2017 TCJA and taxed a child's unearned investment income over a certain threshold if the child is under 18, or over 18 but under 24 if a "full-time student" without significant earned income. Under prior law, unearned income of the child was taxed at the parents' rates. Under the 2017 Tax Act, unearned income was taxed using the trust tax rates, which are as follows:

Ordinary Taxable Income (2022)	Ordinary Taxable Income (2023)	Ordinary Taxable Income (2024)	Ordinary Income Tax Rate
$0 - $2,750	**$0 - $2,900**	**$0 - $3,100**	10%
$2,751 - $9,850	**$2,901 - $10,550**	**$3,100 - $11,150**	24%
$9,851 - $13,450	**$10,551 - $14,450**	**$11,150 - $15,200**	35%
$13,451 +	**$14,451 +**	**$15,200 +**	37%

The lower trust brackets save $3,659 in income taxes on the first $15,200 of income. This increases to $5,624 if the 3.8% Net Investment Income Tax is also saved (additional savings of $5,624-$3,659=$1,965).

Capital Gain Income (2022)	Capital Gain Income (2023)	Capital Gain Income (2024)	Capital Gain Tax Rate
$0 - $2,800	**$0 - $3,000**	**$0 - $3,150**	0%
$2,801 - $13,700	**$3,000 - $14,649**	**$3,150 - $15,450**	15%
$13,701 +	**$14,650 +**	**$15,450 +**	20%

A student is "full-time" if enrolled on the first day of at least five calendar months in the year.

Potential Section 199A Savings

High Income Taxpayer with No Section 199A Deduction

Total Taxes on $609,350 of Income at 40.8% (37% + 3.8%) = $248,614 of Income Taxes

Low Income Taxpayer with No Section 199A Deduction

$191,950 of Income for Single Taxpayer = $39,106 of Income Taxes

(20.37% Effective Rate)

Savings From Income Tax Rate Brackets and Medicare Tax (Assuming No Section 199A Deduction) = $39,210

Low Income Taxpayer with Section 199A Deduction

$ 191,950 of Income for Single Taxpayer = $37,219 of Income Taxes

(19.38% Effective Rate)

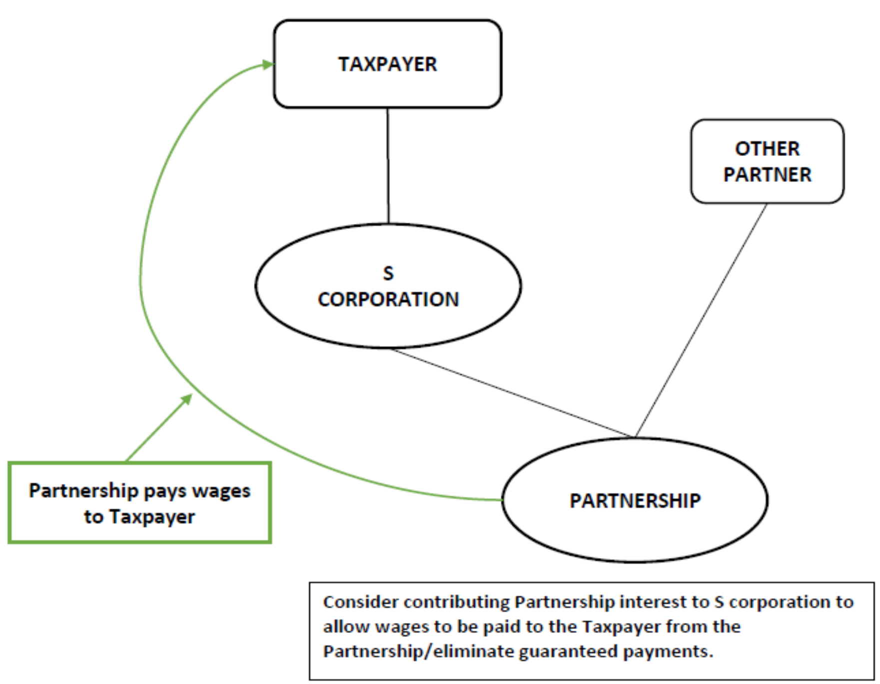
Additional Section 199A Savings = $9,436

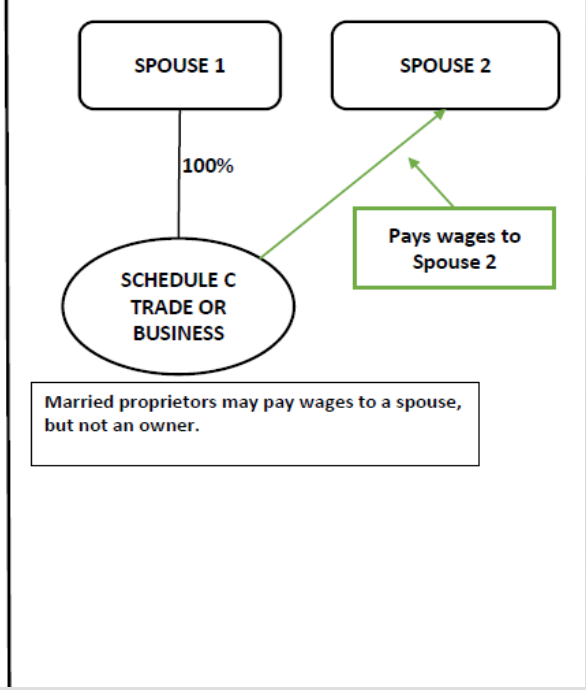
Total Savings if Kiddie Tax and 3.8% NIIT Avoided = $48,660

Chart 2 – W-2 WAGES BY ENTITY CHART. This chart simplifies who can be paid W-2 wages for the purposes of maximizing a Section 199A deduction from the standpoint of the flow-through entity:

Which employees below can be paid W-2 wages by the business structures listed on the right?	Sole Proprietorship	Partnership	S Corporation
Owners/employees with ownership interest	No	No	Yes
Non-owner employees	Yes	Yes	Yes
Spouses (with no ownership interest)	Yes	Yes	Yes
Independent contractors	No	No	No

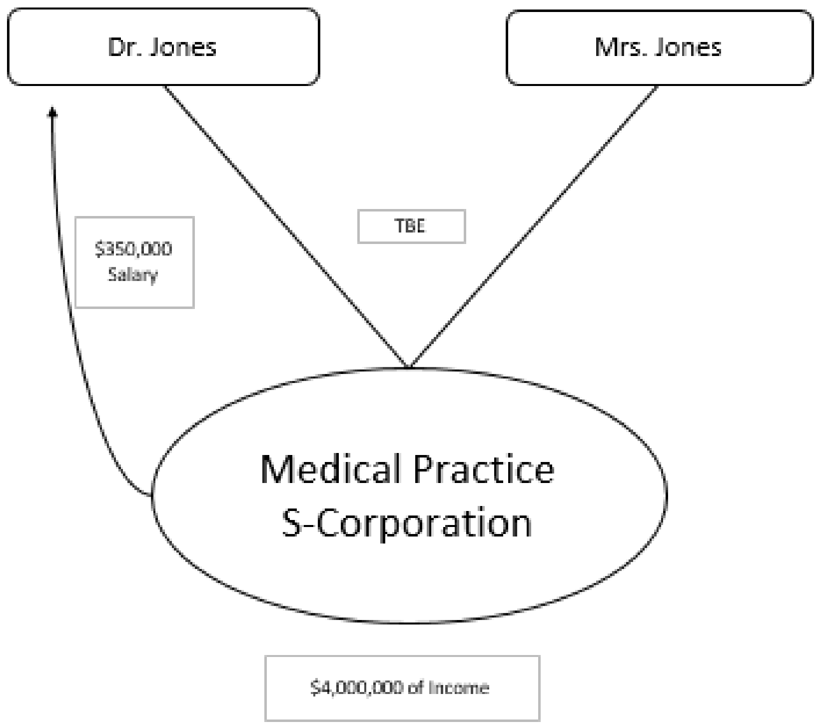
Opportunity 1





Opportunity 7

BEFORE 199A PLANNING



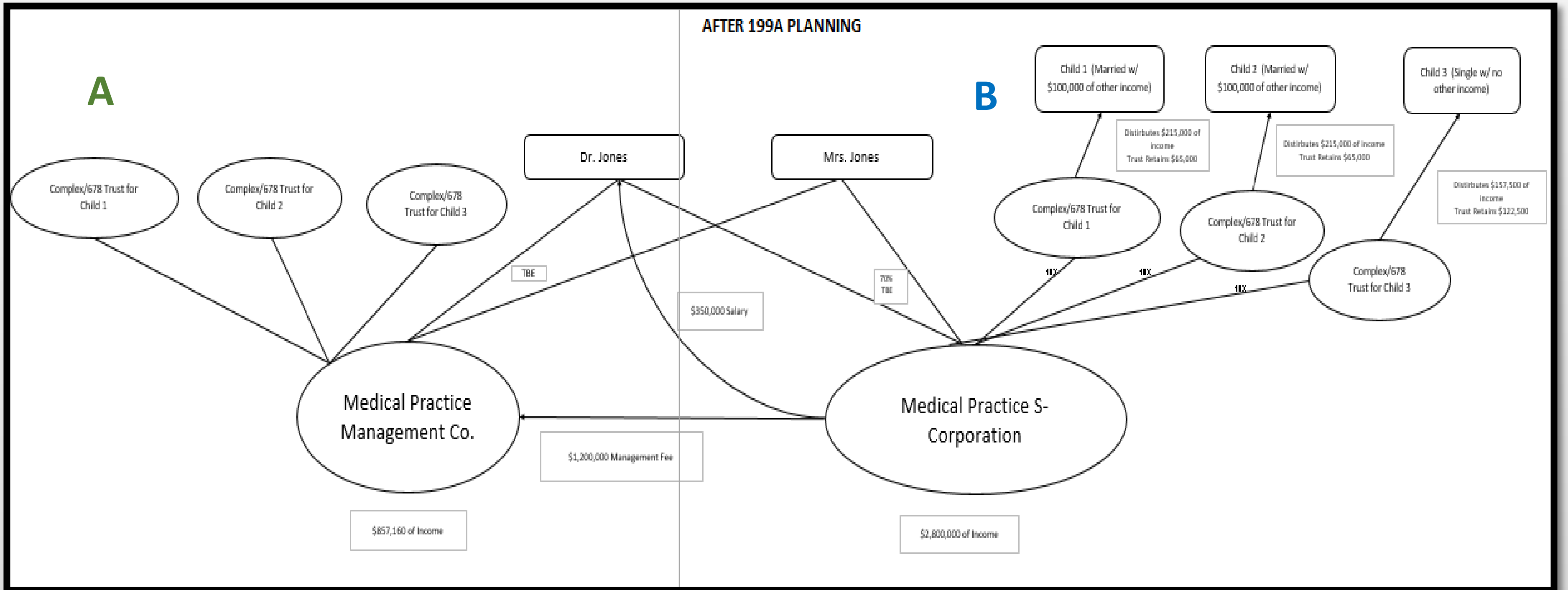
Dr. and Mrs. Jones have $4,350,000 of taxable income and pay income taxes of $1,548,879 for an effective tax rate of 35.61%.

Dr. Jones will also owe $26,972 in Employment Taxes.

Total Taxes = $1,575,851

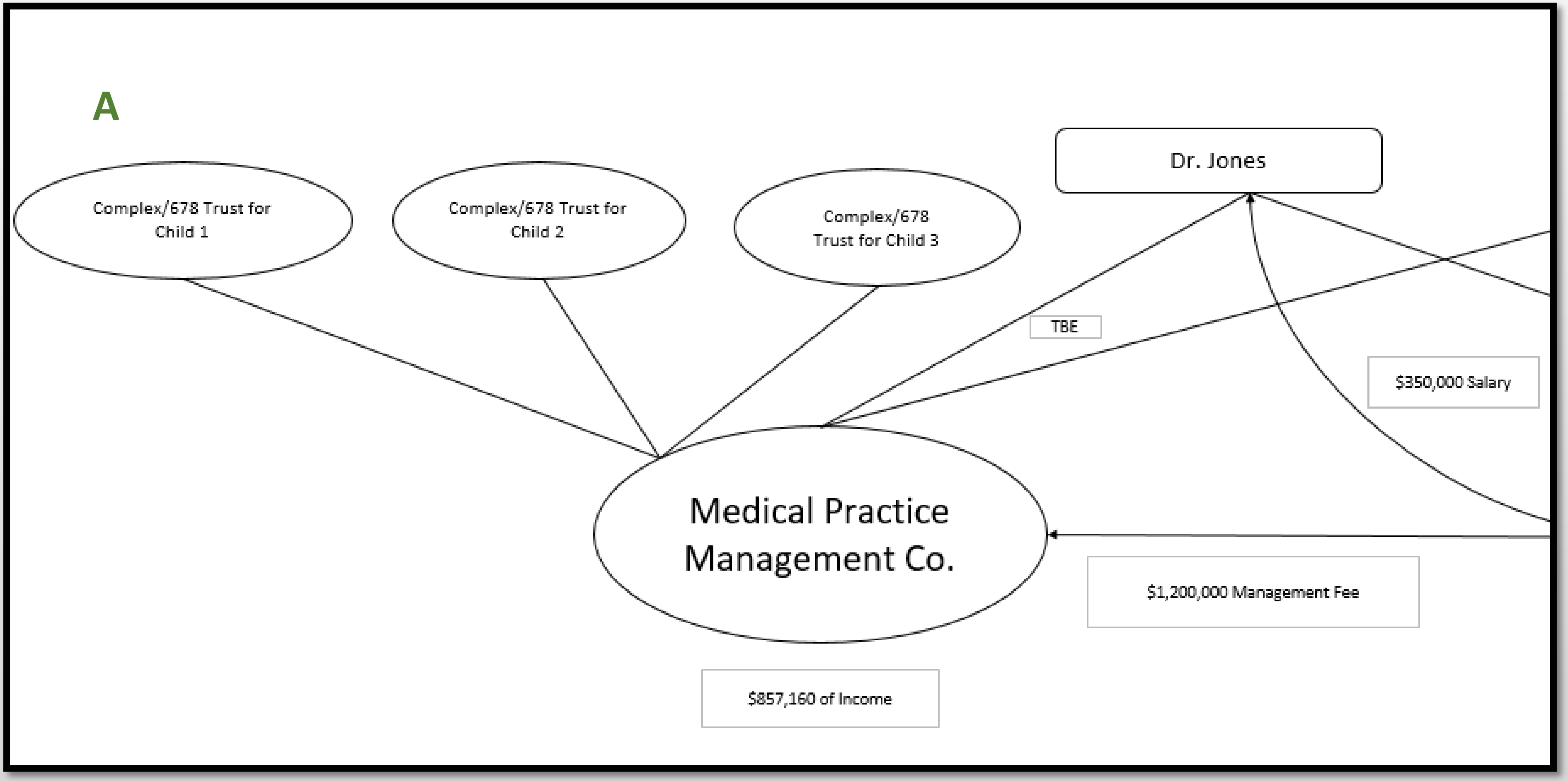
Chart is zoomed in on next two slides.

Opportunity 7



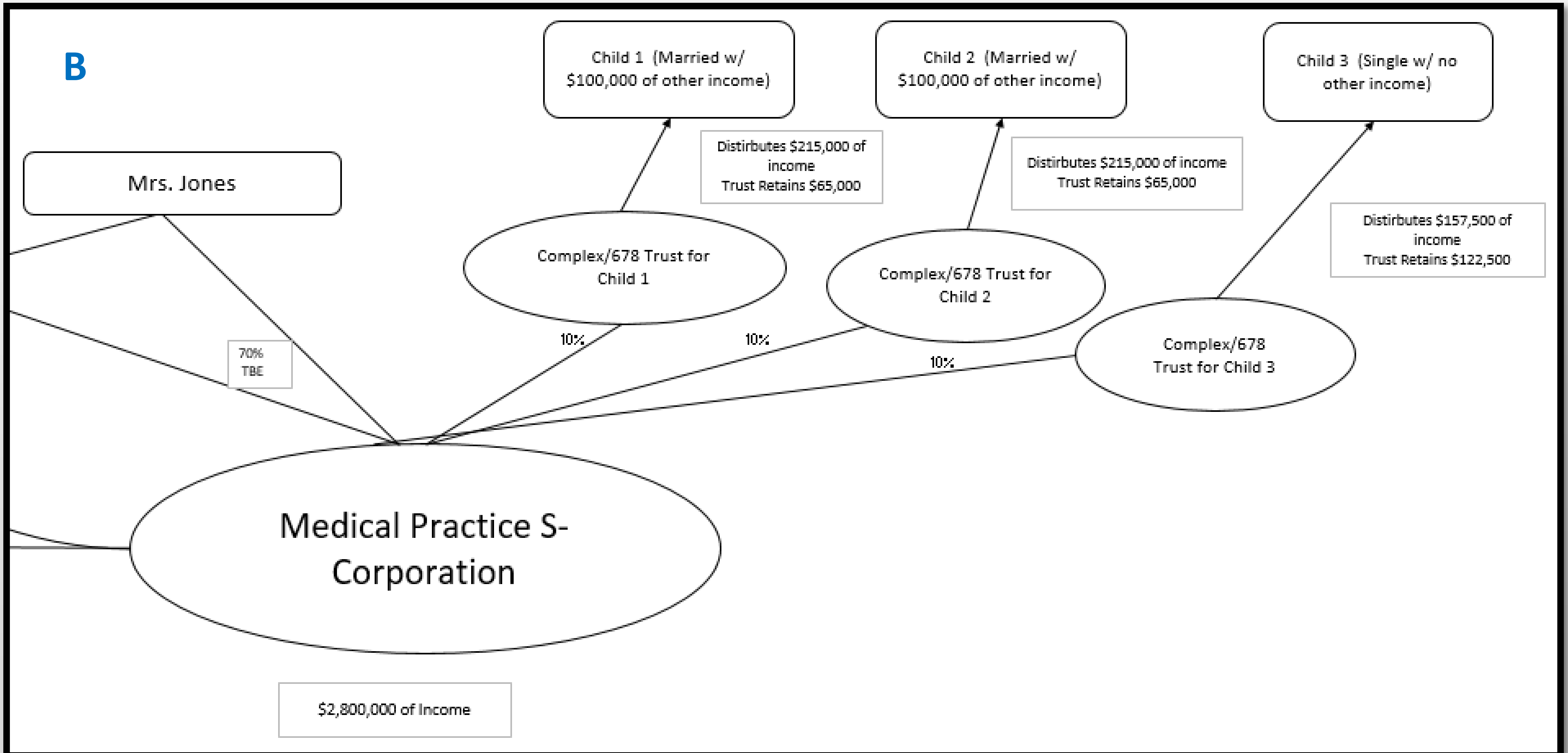
AFTER 199A PLANNING

Opportunity 7



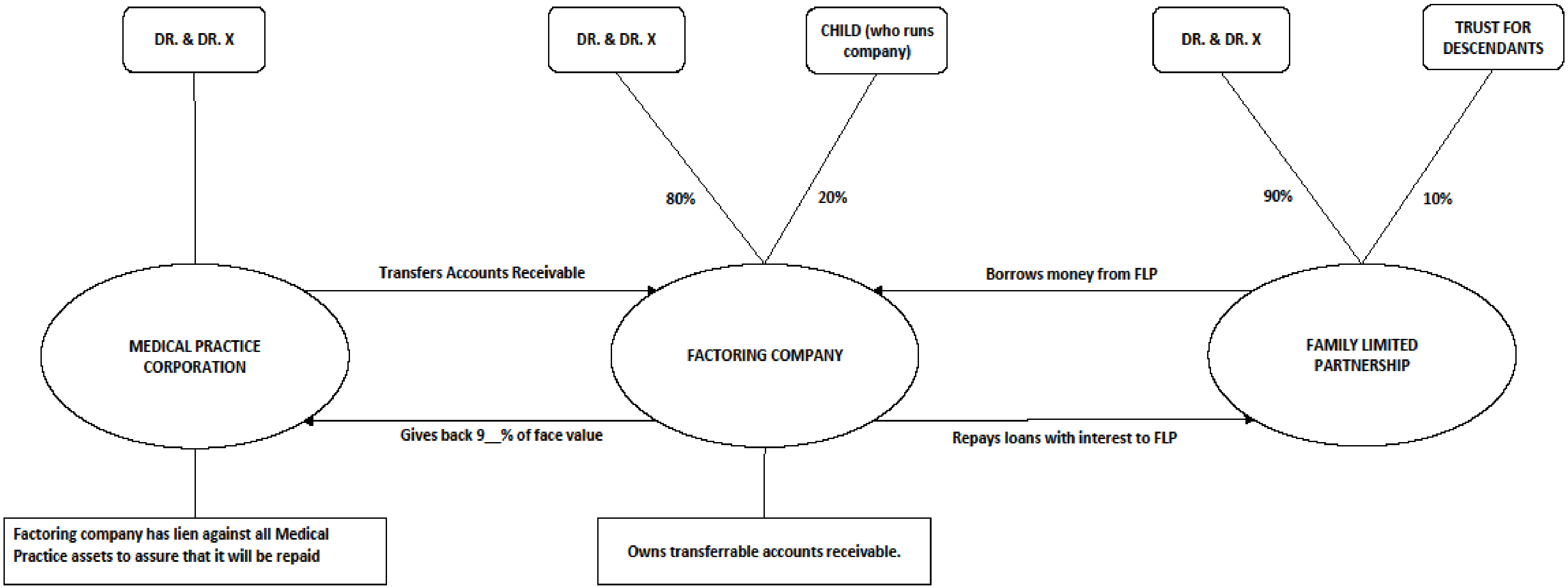
AFTER 199A PLANNING

Opportunity 7



FLOW THROUGH ENTITY DEDUCTION PLANNING EXAMPLE

Opportunity 7



NOTE - Transfer Pricing means what one related company charges another for goods and/or services, and must be "at arm's-length at fair market value."

Use of Management Company and Related Arrangements

Excerpt from LISI Income Tax Planning Newsletter #136, Published March 12, 2018

Planning for Section 199A could be problematic and challenged by the Service under the face of Section 269A where the company primarily performs services for one other company or other entity. Consider the following:

- Substantially all of the services of a PSC are performed for (or on behalf of) one other corporation, partnership, or other entity.

- While the principal purpose for forming the PSC is not the avoidance or evasion of Federal income tax by securing the benefit of a deduction (e.g., under Section 199A), which would not otherwise be available because the PSC pre-existed, a new entity (division, subsidiary or brother-sister entity) would have in fact been formed for this purpose.

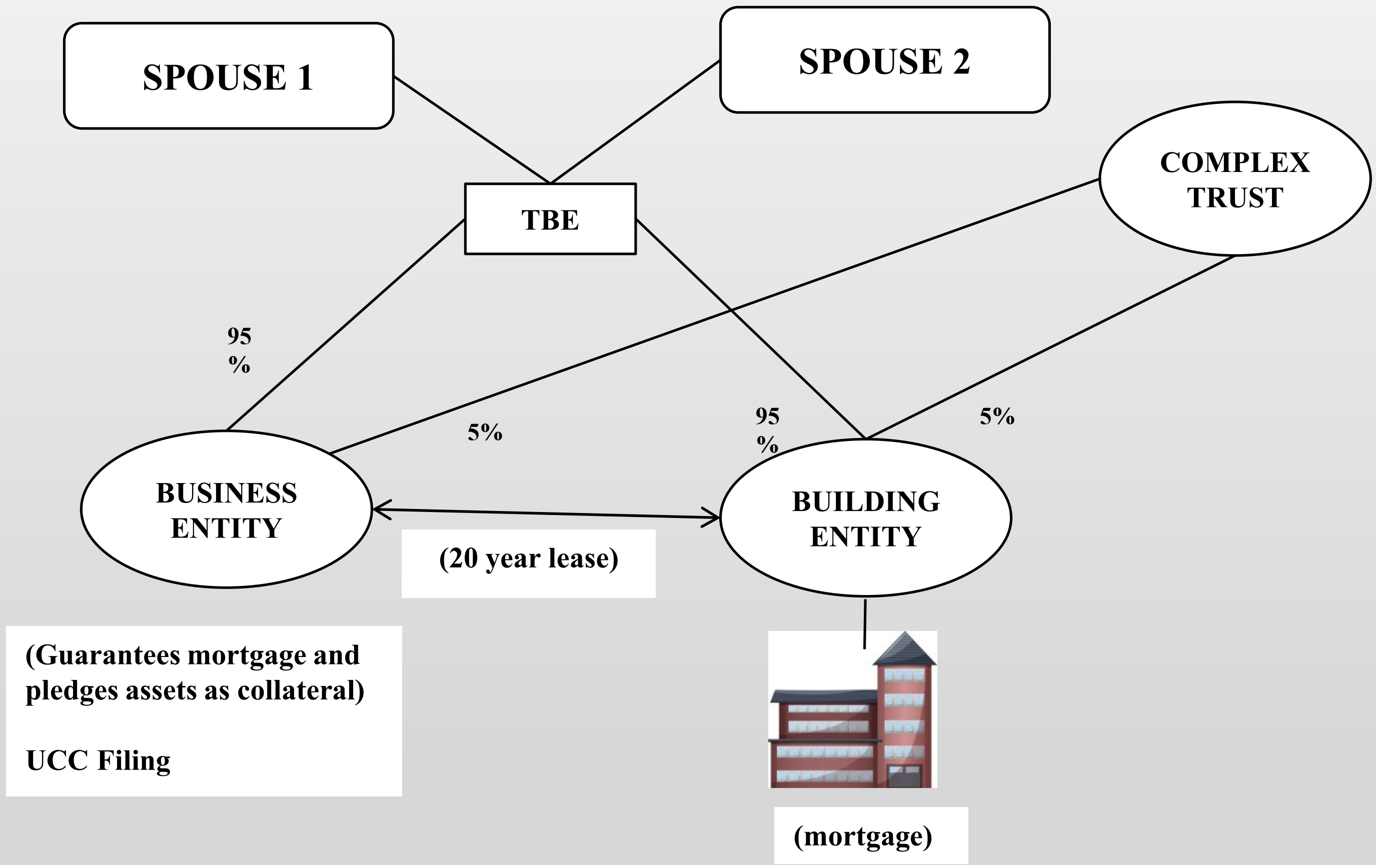
- It may be argued that the new division or entity providing non-SSB services should not be a PSC, as its principal activity is not the performance of personal services, caution should be exercised as the Section 269A and 199A definitions of personal services are not the same.

- Most worrisome, perhaps, is that Section 269A permits the IRS to treat all related persons (within the meaning of Section 144(a)(3)) as one entity. Might that be interpreted to negate the bifurcation of non-SSB and SSB revenue sources? But if the future Regulations indicate that separate entities are not required and that accounting for non-SSB and SSB revenue sources internally under one entity will be sufficient then, perhaps, Section 269A has no bearing on the ultimate Section 199A tax result?

Coordination Of Buildings And Businesses

Debt on building may protect assets of business equity.

Lease obligation to landlord company provides further protection.



TBE and charging order protection, along with cross-collateralization to protect a married couple's business and investment assets, and reduce federal estate tax.

Section 199A Strategies

Let's talk now about strategies as opposed to the 199 technical points that we could spend the rest of our time reviewing.

These strategies are "take it back to the office and apply it" items that can save solid tax dollars for your clients, and give you a useful checklist for what your law firm or CPA firm can do to help clients qualify for the strategy.

Taking into account that single taxpayers with under $157,500 in taxable income and married taxpayers with under $315,000 can take the deduction for any specified trade or business, and without reference to whether wages or qualified property levels apply:

a. **<u>Don't Use S Corporations for Low Income Taxpayers</u>**.

Opportunity 9

Do not use an S corporation for these clients, unless you have to have wages to justify a pension plan or can put part ownership under someone other than the taxpayer or the taxpayer's spouse that files a joint return with the taxpayer.

If there is no significant pension plan, and a married contractor can earn $315,000 as a Schedule C taxpayer, do so without going into an S corporation, so that she does not have to pay herself reasonable wages under Revenue Ruling 74-44 and the long line of case law requiring S corporation shareholders to pay themselves reasonable compensation because the wages do not qualify for the Section 199A deduction.

Section 199A Strategies, Continued

b. **Use S Corporations for High Income Taxpayers**.

Opportunity 9

If your client is well over the $217,500, or $415,000 if married, threshold, then the business is probably best suited to be an S corporation to avoid employment taxes and to enable the person to pay himself or herself sufficient wages to qualify.

c. **Minimize or Eliminate Guaranteed Payments From Partnerships**.

Your clients who derive income from entities taxed as partnerships should minimize guaranteed payments that they receive, because this income does not qualify for the Section 199A deduction.

If your client is receiving a guaranteed payment that needs to be wages, then convey the partnership interest to the S corporation if debt does not exceed basis, and the compensation paid to the individual owner of the S corporation does not have to be classified as a guaranteed payment.

Remember that hot assets (ordinary income assets) from the sale of a partnership interest qualify for the 199A deduction.

Opportunity 1

d. **Asset Sales Yielding Ordinary Income Can Qualify Under Section 199A**.

The Final Regulations specifically confirm this for situations where a partner's sale of a partnership interest triggers "hot asset" income (from accounts receivable and appreciable items).

This should also apply where there is a sale of assets and ordinary income form the sale of accounts receivable, and depreciation recapture. Section 1231 business property that qualifies for capital gains will not qualify for the 199A deduction.

Section 199A Strategies, Continued

Opportunity 3

e. **Reduce Income**.

Do whatever you can to get the individual or married couple income below the $315,000/$157,500 levels if this will save considerable taxes:

1. Defined benefit or cash balance pension planning.
2. 199A asset acquisitions.
3. Shelter capital gains in Charitable Remainder Unitrusts or by using deferred exchanges under 1031, which now only applies to investment or business real estate.
4. Oil and gas investments (100% deduction for individual's intangible drilling costs (IDC).
5. Conservation easements.
6. Put other family members to work and on the payroll to reduce taxpayer's income and increase wages.
7. Pay past due and prior earned amounts to others in 2018.
8. Defer sale of capital gain asset to next year if sale will increase income above the threshold levels.

Section 199A Strategies, Continued

f. **Establish Arm's-Length Compensation and Sales Arrangements**. **Opportunity 4**

A specified trade or business owned by a high-earner taxpayer may pay arm's-length management, marketing, billing and factoring fees to a separate company whose income will not be Specified Trade or Service Business income until the Final Regulations come out.

When the Final Regulations come out, the separate company can be owned by children and/or 678 Trusts which are considered as owned by the beneficiary who had a withdrawal right over all assets. Google Gassman Forbes 678 to see an article on this.

The ownership can be under complex trusts, which should receive a $157,500 threshold at both the trust level and at the level of each beneficiary until the Final Regulations come out.

If the Final Regulations restrict use of complex trusts convert the complex trust into a 678 trust, so for each young child, you will have $157,500 times 7% savings.

g. **Plan for Wages**. **Mistake 3**

Remember that the wages need to be 28.57% of what the income without wages would otherwise be, and include not only wages themselves, but also pension contributions and employer paid health benefits.

You may, therefore, already have significant "wages" but may not know it.

Section 199A Strategies, Continued

h. Decide **what income to aggregate** between related companies and what you can do to prevent aggregation in later years. Remember you can't aggregate SSTBs. **Mistake 5**

i. **Separate life insurance agency** income from investment advisory and annuity sales income. **Mistake 1**

j. **Restructure celebrities and well known professionals** so that their earnings come from business operations and not from royalties or endorsements. **Opportunity 10**

k. Make **real estate rentals and other "passive" activities** active in order to qualify such activities for the Section 199A deduction.

Section 199A Strategies, Continued

l. **Pay off loans** to eliminate interest expenses to qualify for a larger deduction, or maintain debt if interest expense will reduce income below the high earner thresholds.

Taxpayers who have made debt decisions based in part upon the deducibility of interest may wish to reconsider normal assumptions, given that the interest deduction attributable to a trade or business that generates income qualifying for the Section 199A deduction will be saving income tax at a lower bracket.

For example, a 37% bracket taxpayer who has an active business that pays $100,000 a year of interest on debt will be saving $29,600 in income taxes instead of $37,000 in income taxes as the result of the interest paid.

If the same taxpayer has a separate trade or business or investment arrangement that is taxed in the 37% bracket, why not pay down the debt owed on the business that qualifies under Section 199A to receive an additional $7,000 in tax savings from the interest deduction?

Under the 2017 Tax Cuts and Jobs Act, businesses with more than $25 million in average annual gross receipts for three preceding tax years cannot deduct interest expenses to the extent that such expenses exceed 30% of their adjusted taxable income.

m. Remember that **1231 property income** – capital gains income from the sale of business property – will not qualify, but losses will reduce 199A income. (See Section 1231 Summary Chart on next slide.)

The Section 1239 rules also apply.

CHAPTER 20
BUILDING BLOCK CONCEPTS FOR BUSINESS, INVESTMENT, AND PROFESSIONAL ASSET ENTITY USE AND PLANNING - THE VERY BASICS OF BUSINESS LAW

There are several different forms of business structures available to physicians and deciding which structure to operate under can be quite challenging. Limited liability, management structure, and tax issues are some of the key factors that should be taken into consideration when selecting an entity for your practice. This chapter provides a basic overview of the various business entities, the pros and cons of each and the tax ramifications.

CORPORATION

Corporations (which normally end with the words Inc., Incorporated, Corp. or Corporations), offer limited liability to their owners, who are referred to as shareholders. Limited liability means that the shareholders will not lose more than what they invested in the corporation. If the corporation fails, the shareholders cannot be sued personally for the corporation's debts. However, while a doctor will still be responsible for his or her legal malpractice liability, it is nevertheless important to operate a medical practice under a corporation or other limited liability entity in order to ensure that the doctor and any other owner will not be responsible for other liabilities, such as for malpractice committed by another doctor or nurse in the practice, automobile accidents caused by employees of the practice who are driving on corporate business, or obligations to creditors if the practice for any reason fails.

A possible disadvantage to forming a corporate entity is the formalized governance structure. Corporations have an elected board of directors who are in charge of making the important corporate decisions. The board of directors appoints officers who run the day to day operations of the corporation. Under Florida law, shareholders have limited ability to manage the corporation. This formal management structure may not be suitable for the single doctor starting his or her own practice. There are also several tax disadvantages to a regular corporation discussed below.

LIMITED LIABILITY COMPANY (LLC)

An LLC offers its owners, referred to as members in the Florida Statutes, limited liability similar to the protection offered by a corporation but also provides the flexible management structure of a general partnership, as described below. For these reasons, LLCs have become extremely popular and remain a good choice for many medical practices.

An LLC is managed by its members who typically vote according to their profits interest in the LLC. Florida also permits members to elect managers who may not be members to manage the company.

PROFESSIONAL ASSOCIATION (PA)

A Professional Association is a corporation formed by licensed professionals including attorneys and physicians. The shareholders are liable for their own malpractice but are not liable for the malpractice of others within the PA.

PROFESSIONAL SERVICE LIMITED LIABILITY COMPANY (PLC OR PLLC)

A PLLC is a limited liability company for licensed professionals in private practice. Many physicians and other professionals choose this entity form because it offers limited liability to its members and tax advantages as discussed below.

GENERAL PARTNERSHIPS (GP)

When two or more persons decide to form a joint venture for profit they may form a general partnership. A general partnership does not offer limited liability to its owners, who are referred to as partners. Each partner is personally jointly and severally liable to third parties for all obligations of the partnership. This characteristic makes general partnerships very unpopular.

Unlike corporations, Florida law provides that each partner has the right to participate in the management of the partnership. While the management structure may be less formal than a corporation a general partnership is not recommended for physicians.

LIMITED PARTNERSHIPS (LP)

A limited partnership differs from a general partnership in that there are two types of partners: (1) limited partners and (2) general partners. Under Florida law, a limited partnership must have at least one general partner and one limited partner.

A limited partner has limited liability but does not have the right to manage the partnership. A limited partner may lose his limited liability if he holds himself out to third parties as a general partner and the third party reasonably relies on his actions to assume he is a general partner.

Unlike a limited partner, a general partner does not have limited liability and may be personally liable for the partnership's debts. As discussed below, entity layering is a suitable solution to this potential disadvantage by forming a corporation to serve as the general partner in a limited partnership. However, the general partner has control over the business decisions and therefore owes fiduciary duties to the partnership and other partners.

LIMITED LIABILITY PARTNERSHIP (LLP)

A Florida Limited Liability Partnership offers limited liability to its partners, but not charging order protection. LLP's are often confused with LLLP's, so please be careful to make sure that any limited partnership formed and maintained for you has been handled properly.

LIMITED LIABILITY LIMITED PARTNERSHIP (LLLP)

A Florida LLLP is similar to a limited partnership but also offers liability protection to both general and limited partners. Therefore, it is preferred over a limited partnership and should not be confused with an LLP.

ENTITY SELECTION FOR PHYSICIANS

For hundreds of years business arrangements have been designed using multiple companies so that valuable assets owned by one company would not be lost as the result of liabilities incurred by another company.

Just as shipping companies in the 1700's leased boats to operating companies so that the boat would not be lost in a lawsuit caused by operation, medical practices will often have one company that owns and operates the medical practice and another entity that owns the expensive equipment and real estate and leases it to the practice entity.

For many years it was assumed that Florida law required medical practices to be operated under PAs or PLCs, and the Florida Statutes require that a PA or a PLC must be owned solely by one or more licensed medical doctors or DO's. As the result of this assumption the vast majority of doctors up through the 1990's owned their medical practices under PAs or PLCs, or "partnerships of PAs" or PLCs. We discuss partnerships of corporations below.

From 2000 through 2005 it became evident that a normal LLC or regular corporation could own and operate a medical practice, although there are special Florida clinic rules that require a corporation or other entity that is not wholly owned by doctors and their family members and trusts for family members must go through special registration and monitoring requirements.

As a result of the above many physicians now own their medical practice corporations jointly as tenants by the entireties with spouses so that a pre-practice establishment liability will not cause loss of ownership of the practice entity. Examples of the types of liability that this can protect from include malpractice that may have been committed before the new entity was started, car accident liability, and bank debt liability where only one spouse has signed as a guarantee.

Clients have us convert their professional association or PLC into a regular corporation or LLC and place ownership jointly as tenants by the entireties with the spouse or partly into a trust for children or other form of ownership in order to obtain charging order protection, which is described in Chapters 13 and 16.

A common arrangement would therefore be for a doctor and his or her spouse to own a medical practice entity as tenants by the entireties, and to have a separate limited partnership or LLC owned by the husband, wife, and a trust for the children own the office building and improvements to the office building.

When this occurs the practice entity will pay rent to the office entity and may take a lien on the practice assets under a security agreement, as explained at the end of this chapter.

THE TAXATION OF BUSINESS AND PRACTICE ENTITIES

Now that we have covered the basic forms of corporations, LLCs (and limited partnerships) we can now provide building blocks knowledge on the federal income tax treatment of each entity.

The basic tax treatment alternatives for business and investment entities are (1) disregarded, (2) taxed as a partnership, (3) taxed as an S corporation, (4) taxed as a regular (C) corporation.

DISREGARDED ENTITY STATUS

An LLC owned by only one person or other entity can elect to be disregarded for federal income tax purposes. This means that a person can own an LLC, and all income and deductions of the LLC would simply be reported on that person's personal income tax return as if the LLC did not exist.

Some advisors mistakenly believe that an LLC that is disregarded for income tax purposes does not offer the same creditor protection features (firewall protection and charging order protection) as an LLC that elects to be treated as a separate taxable entity, as described below, but this is not the case. It is possible to structure "disregarded entity" LLCs to provide firewall protection and charging order protection if done correctly.

Typically a disregarded entity LLC will apply for a separate taxpayer identification number and it is important to follow all appropriate corporate formalities when an entity is disregarded for income tax purposes.

A regular corporation cannot elect to be disregarded for income tax purposes. LLCs and limited partnerships, however, may be treated as disregarded if they are considered to have only one member for federal income tax purposes.

It is also possible to establish irrevocable trusts that are disregarded for income tax purposes. If a person forms an irrevocable trust for their children and also establishes an LLC owned 70% by the person and 30% by the trust for their children, then the LLC can be disregarded for income tax purposes.

PARTNERSHIP TAX STATUS

An LLC or partnership entity with more than 2 members can be structured in order to be taxed as a partnership. Under the federal income tax laws the income and deductions of a partnership generally pass through to its partners. The partnership pays no tax, but is primarily a reporting entity.

A partnership tax return is filed showing all income and deductions of the partnership, and then the partners receive K-1 forms ("Form K-1") informing them and the IRS of their individual share of the income and deductions of the partnership. This is called a Form 1065.

Partners can therefore be subject to income tax on income that they did not receive, which can be called "phantom income."

The partnership tax law is extremely complicated, and individuals making use of partnership entity planning should have competent legal and tax advice.

Partners who are active in a partnership will usually be subject to social security and medicare taxes on all earnings associated therewith. For this reason most medical practice entities elect to be taxed as S corporations as opposed to being taxed as partnerships.

PARTNERSHIPS OF S CORPORATIONS

Many of our clients and advisors prefer to have their medical practices owned by an LLC or partnership entity that is taxed as a partnership, and to have the LLC or partnership entity in turn owned by companies or LLCs treated as S corporations in order to allow for profits to pass through as dividends, and for practice income to be offset by expenses that can be controlled at the individual S corporation level as opposed to having all of the owners in the practice involved with decision-making and questions such as whether and how much to pay for travel and entertainment, furniture and equipment used at home for the practice, whether to have an automobile held under the professional corporation, and what family members to have on the payroll so that they can be compensated for their contribution to an individual doctor's personal and professional practice.

REGULAR CORPORATIONS CANNOT BE TREATED AS PARTNERSHIPS

Regular corporations cannot be treated as partnerships for federal income tax purposes. By regular corporations we mean non-LLCs, which include conventional corporations and professional associations (PAs). PLCs are treated as LLCs for the purpose of these rules, and can therefore be treated as disregarded if there is only one owner, as a partnership if there are multiple owners, or as an S corporation or C corporation whether there are one or more owners, as described below.

S CORPORATIONS EXPLAINED

An LLC, a regular corporation, a professional association and in some instances a limited partnership or limited liability limited partnership may elect to be treated as an S corporation.

Like a partnership, an S corporation pays no taxes of its own, but instead files an income tax return called an 1120S and in the process issues a K-1 form to each shareholder informing them of their ratable share of income and deductions. Salaries paid to owners and non-owners are treated as deductions for the Form 1120 tax return.

Unlike a partnership, however, K-1 income received by an active shareholder or member will not be subject to social security taxes or the Medicare 2.9% tax unless the IRS can show that dividends received were actually wages. For this reason, it is extremely important to pay yourself an adequate salary.

A typical S corporation arrangement could entail an S corporation owned by a husband and a wife and operating a medical practice that the wife works for as a physician.

The S corporation may have 7 employees, and the physician-owner may receive $250,000 a year as dividends. The husband and wife who are the owners of the company may also receive $300,000 a year in dividends on average.

The wife would pay social security and Medicare taxes on the $250,000, but the $300,000 of excess income would only be taxed as ordinary income, and would not be subject to social security tax or Medicare tax.

On audit, the IRS may determine that a substantial part of the dividends should have really been classified as compensation to the wife based upon a substance over form analysis. If the IRS is successful then the couple could end up paying employment taxes, interest, and possibly even penalties on the $300,000 the classified as ordinary income.

Fortunately, S corporation audits have been very rare in the past, but the IRS has been ramping up significantly to review S corporation dividend situations.

Pension planning is discussed in Chapter 16 of this book, and in order to maximize pension plan contributions for a working physician it is often necessary to pay a minimum of $255,000 in compensation for 2013. This amount was $250,000 for 2012 and $245,000 for 2011 and adjusts annually for inflation.

It is vitally important that an S corporation have appropriate documentation and an accurate application filed with the IRS to elect to be treated as an S corporation by filing a Form 2553.

The Form 2553 should exactly indicate the ownership of the S corporation, as of the date that the S-election is made, as reflected in its legal documents.

The S corporation rules are very strict, and a high percentage of LLC Operating Agreement forms normally used by legal practitioners are inconsistent with the S corporation rules. Using the wrong type of operating agreement can be catastrophic, since the S-election can be lost retroactively and then be treated as a "double taxed C corporation" as described below.

The distribution of appreciated assets from an S corporation causes income tax to occur as if the assets were sold at arm's length, and S corporations cannot be owned by non-resident aliens, C corporations, or partnerships. For this reason most real estate and general investment endeavors are structured to be taxed as partnerships, and not S corporations.

Obviously it is necessary to have good legal and tax representation in determining what type of entity to form, and to make sure that the entity is properly formed, documented, and reported.

CAUTIONARY ADVICE

When multiple entities exist, it is important to properly structure and account for each separate entity and activity to help assure that the "corporate veil" will not be pierced. Florida law makes it very difficult for a creditor to "pierce" a corporate veil, particularly where there has been proper planning, documentation, and fiscal conduct. However, improper documentation can cause the entity to be invalid.

There has been a significant trend by which physicians or irresponsible accountants file Articles of Organization to form their own LLCs with Tallahassee, and do nothing with reference to the needed documentation that the IRS, banks, and creditors expect to see in order to uphold the validity of the entity. <u>Do not rely upon any accountant or other advisor who tells you that all you need to do is form the entity with Tallahassee and does not provide the proper legal documents</u>.

When you go to your estate planning lawyer ask whether they have the expertise to take a quick look at your entity legal documents to make sure that they have been properly formed in a manner consistent with the tax treatment and business relationships.

REGULAR CORPORATION TAX TREATMENT

The final type of taxation for a corporate or partnership entity is as a regular corporation, also known technically as a "C corporation".

C corporations are more commonly used for small non-medical practice businesses, because they are in a lower tax bracket on their first $10,000,000 of net income, making it easier to accumulate capital from earnings.

Regular corporations are treated as complete separate taxable entities, so they calculate their revenues and expenses and the corporation itself pays federal income tax each year or if there are losses that cannot be used by the shareholders.

C corporations that engage in the practice of medicine or other licensed professions are subject to income tax at the highest individual tax rates beginning on the first dollar of net income, and are therefore rarely used or appropriate for medical practices.

If your medical practice is taxed as a C corporation then there are a number of important reasons that you should consider converting the corporation to an S corporation or migrating the medical practice out of the C corporation into a new entity. The S Corporation election rules are complicated when you have an existing regular corporation that is converting to an S Corporation, so appropriate tax counsel should be consulted with when that occurs. Most prudent CPAs have a tax lawyer become involved in that situation.

Effective January 1, 2007, almost any kind of business entity in Florida can convert to almost any other kind of business entity. Therefore, many regular corporations are being converted to LLCs. For tax and other purposes, however, it is important to properly coordinate such conversions.

SUMMARY OF TAX TREATMENT CHOICES

Based upon the above, the major choices of entity selection are as follows:

1. An LLC that is disregarded for income tax purposes to provide firewall and possibly charging order protection without necessitating a separate tax return or tax compliance.

2. An LLC or partnership taxed as a partnership, which will normally be used to hold investments and/or real estate.

3. An LLC or corporation taxed as an S corporation to shield earnings from employment taxes and Medicare tax.

4. An LLC or partnership entity taxed as a regular corporation to allow the accumulation of earnings at lower taxable rates if the entity is not a medical practice.

Please keep in mind that the above discussion is intended to be useful to physicians and their advisors who are attempting to understand how these concepts work and how they apply to them, but does not substitute legal counsel.

COMMON MEDICAL PRACTICE STRUCTURES

For the purpose of repetition in learning for the reader, medical practices can be structured in several different ways, and each way has its advantages and disadvantages.

The primary arrangements that we see are as follows:

1. A Single Doctor Practice under an LLC or Corporation.

Here one doctor practices under a company owned by the doctor or by the doctor and the doctor's spouse as tenants by the entireties.

If the doctor has had a prior practice and is concerned that malpractice or other individual liabilities could cause loss of ownership of a new medical practice then it is often best to have the spouse as a joint owner.

Ownership itself will not cause a spouse to be responsible for malpractice or other corporate liability.

Commonly the company will be a professional association ("PA") or professional limited liability company ("PLC"), and a professional company must be owned only by licensed professionals.

Under Florida law a medical practice can be owned by non-doctors and does not have to be a PA or a PLC, but if a non-spouse is an owner, there are Florida statutes that may require special registration under the Health Care Clinic Act.

Typically the company should be taxed as an S corporation so that dividends paid will not be subject to a corporate level tax or self-employment taxes.

Some older medical practice companies are "C corporation," and should consider converting to S corporations.

2. Multiple Physician Practices.

Where multiple physicians own a medical practice there are several variations on how to best structure ownership.

(a) Sharing a Single Corporation. Typically the doctors will share an S corporation or a C corporation, but any C corporation income not bonused out will be subject to corporate level tax, and all compensation paid to the doctors will be subject to the 2.9% Medicare tax.

S corporation status is common, but under the "second class of stock rules" it is often not possible to legally divide income to take into account Stark Law designed health services without losing the corporation's S-Election or violating health care law.

(b) Most single entity practice companies are taxed as S corporations. This works well for individual physicians, but for multiple physician practices, it often works best to establish a separate S corporation for each doctor, and for these S corporations to own an LLC that can be taxed as a partnership.

This allows for income to be distributed in any legal manner without running afoul of the S Corporation distribution rules, and each physician to make his or her own determination as to amounts to be received for salary, bonuses, distributions, and fringe benefits. Any pension independence needs to be designed and monitored by an actuary or other pension plan expert.

3. Hybrid Arrangements.

There are many hybrid arrangements that can be considered.

MEDICAL PRACTICE ENTITY PLANNING

Important decisions include how much money to characterize as wages and salary, and how much money to characterize as dividends or profit distributions.

Wages and salary, including compensatory bonuses, are subject to the Medicare tax, which is a 1.45% tax paid by the practice (and tax deductible) and a 1.45% tax paid by the individual employee (and not tax deductible).

Pension contributions are often limited to a specific percentage or level based upon salary, but salaries exceeding $255,000 will not be counted for pension contributions for 2013, and this level can adjust annually.

Wages may not be protected from creditors for the physician who is a head of household unless there is an employment agreement in place, and other arms length arrangements which are not completely clear under present Florida case law. Physicians who are the head of household are well advised to have an employment agreement in place that provides for fixed monthly or more frequent wages, and to make sure that the wages are paid as set forth under the employment agreement.

Sometimes equipment and various separate functions or practice endeavors may be established under separate LLCs, which may be owned by the doctor and/or the doctor's spouse, and trusts for children.

WAGES VS. DIVIDENDS VS. OTHER CHOICES

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A SAMPLE MEMO TO A CLIENT: "CHOOSING THE RIGHT BUSINESS STRUCTURE FOR YOUR PRACTICE"

Dear Client,

Where professional planning is concerned, the structuring and protection of a physician's private practice are critical. In a physician's life, unlike some other professionals who work for large corporations, professional and personal planning are often closely intertwined, and it is therefore more imperative that a physician has quality planning in place, written and executed by trusted and competent advisors.

The tax law is extremely flexible when corporate, partnership, and tax entities are thought through in advance and properly coordinated.

Physicians often utilize Limited Liability Companies in their planning. These entities are discussed in greater detail below.

1. What is a Limited Liability Company?

A Limited Liability Company ("LLC") is a special kind of entity, authorized under state law, which provides limited liability to its members much like shareholders in a corporation.

As a matter of terminology, the owner of an LLC is called a "Member." Of the appointed Member or Members, the individual or entity with the ability to manage and control the LLC and is called the "Managing Member" or "Manager." The name of an LLC must end with the As a matter of terminology, the owner of an LLC is called a "Member." Of the appointed Member or Members, the individual or entity with the ability to manage and control the LLC and is called the "Managing Member" or "Manager." The name of an LLC must end with the words "Limited Liability Company" or "L.L.C." instead of "Inc.," "Corp.," or "Corporation."

As with a limited partnership (under the laws of most states), a creditor of the Member cannot directly obtain assets owned by the LLC. The creditor of a Member can only receive a "charging order" against the LLC. A charging order is an order from the court mandating that, if and when the LLC makes distributions, the distributions attributable to that Member whose interest is subject to a lien (the "Debtor/Member"), must be paid to the creditor.

A Debtor/Member can still receive compensation from the LLC without having to share any of that compensation with the applicable creditor. This charging order limitation makes an LLC superior from a creditor protection standpoint to a regular Florida corporation, particularly for high-risk owners who have the possibility of a creditor claim being imposed against their ownership interest.

An LLC should not be confused with a limited partnership (LP), a limited liability partnership (LLP), or a limited liability limited partnership (LLLP), as these are completely separate entities with different characteristics. In some cases, one of these other entities will be preferable to an LLC, and it may be feasible to convert an LLC into one of these entities or vice versa.

2. How is an LLC taxed?

From a federal and state tax law standpoint, an LLC can be taxed in one of the following ways:

(a) Disregarded. A Single Member LLC (an LLC owned by only one person or entity) can be completely ignored and considered transparent for federal tax purposes.

A Single Member LLC does not necessarily need to apply for a tax identification number. The tax identification number of the LLC may be the owner's Social Security Number, or the identification number of another entity which is acting as the sole Member of the LLC. Tax returns are not required to reflect the LLC's existence, although it is advisable that the LLC file a separate tax return for state law/creditor protection purposes.

A Single Member LLC may even own a person's homestead and qualify for the exclusion for capital gains on the sale of homestead property. The majority of Florida residents, however, will want to continue owning their homestead personally because of the superior creditor protection afforded to individuals who reside in Florida. Under Florida law, one half acre of a homestead located within city limits and 160 acres of a homestead within county limits is protected. Florida residents whose homestead property exceeds these limits should consider placing the excess acreage in an LLC for additional creditor protection.

Besides charging orders and tax neutrality, discounts as to valuation offers yet another significant tax advantage to forming a Single Member LLC. Although an individual can own 100% of an LLC, if a third party, which may include a trusted relative, is named the Manager of the LLC, with the power to make decisions and to withdraw management fees without the joinder or consent of the 100% Member/Owner, then on the death of the Member/Owner a significant discount may apply to the value of the LLC, thereby reducing the potential estate tax liability.

(b) Partnership Treatment. An LLC with more than one Member is automatically treated as a partnership for tax purposes, unless an election is made to the contrary. A multiple-member LLC formed in the United States or certain other countries will presumably be treated as a partnership for federal tax purposes, unless a special election is made by the Members as described below.

(c) Corporate Treatment. An LLC may be treated as an S corporation or a C corporation for federal tax purposes, provided its Member(s) file a Form 8832 as described below.

NOTE: Creditor protection will be the same whether an LLC elects to be treated as an S corporation or not. There is a common misconception that S corporations do not offer the same type of "firewall" protection as regular corporations do. LLCs taxed as disregarded entities or as S corporations offer the same protection of shareholders as any other type of company.

An LLC or corporation that elects to be treated as an S corporation will have all of its income and deductions flow through via K-1 tax reporting to its owners/shareholders, so the company pays no corporate level tax.

Subject to a few complexities, the main thing to know about S corporations is that all shareholders have to be treated equally as far as rights and distributions concerning their shares. There can be no "second class of stock" with an S corporation, or the S election is lost and all corporate level income is subject to tax, both at the corporate level and as dividends to the shareholders.

An example of a second class of stock would be that a particular shareholder gets all of the income attributable to his or her efforts as dividends, or that one shareholder has the right to receive a certain dollar amount upon retirement in exchange for stock, based upon a formula that would not necessarily apply to all of the shareholders.

In many cases, it is not possible to comply with the Stark and various state regulatory statutes under an S corporation unless all income associated with employed physicians, ancillary services, and otherwise allocated by formula is paid out as compensation, except to the extent equally divided as dividends.

Transfer of an appreciated asset from an S corporation, which may include goodwill, will trigger income tax as if the asset were sold.

A company can also be treated as a "C corporation" or regular corporation, which is a company or LLC that is taxed as a separate entity and actually pays income tax on its net income.

(d) Electing Status. Under the "check the box regulations," the Members may select between partnership and corporate tax treatment. Absent an affirmative election, a Single Member LLC will be ignored for tax purposes. An LLC with two or more Members will be considered a partnership for federal tax purposes, unless a Form 8832 or a Form 2553 is filed with the Internal Revenue Service within the first 75 days of the LLC's existence, affirmatively electing to have the LLC treated as a corporation for federal tax purposes.

If the LLC is to be treated as a regular corporation, a Form 8832 is used. If the corporation is electing to be treated as an S corporation, then a Form 2553 is to be used. In the past, the IRS required that S elections be made by first filing a Form 8832 and then filing a Form 2553, but this redundant process was eliminated in 2004.

Please schedule an appointment with me to further discuss the advantages of organizing your practice as an LLC.

Best personal regards,
Attorney

DEBT IS THE DEBTOR'S (AND THE DOCTOR'S) FRIEND

Once a creditor has a lien or mortgage on assets, no other creditor will be able to take those assets, unless they pay the original creditor or find another legal avenue to invalidate or set aside the original creditor's lien. In general, most creditors will not make efforts to reach assets that are already owed to another creditor.

While there are some exceptions to this rule, debt, when properly used, can actually be a good creditor protection mechanism. A memorandum written for physician clients of the author is as follows:

We are finding that plaintiff lawyers are asking about the value of medical practice assets before being willing to settle malpractice cases against doctors and their medical practice entities.

While furniture and equipment may be protected by being held in a separate entity and leased to the medical practice, accounts receivable must arise from billings generated by the medical practice, and are going to be owned by the medical practice unless they are immediately assigned and/or factored, which is no easy feat.

Assuming that the medical practice will own the accounts receivable, the only way to "protect them" from a potential judgment creditor is to have legitimate debt owed and secured by the accounts receivable of the practice entity well before a suit.

A Security Interest is granted by giving a legitimate lender a UCC-1 filing, which is based upon a Security Agreement and appropriate documentation forwarded to Tallahassee. The lien then becomes of public record as of the date filed, and gives the lender the equivalent of a mortgage on the assets liened. The lender is then in a position to declare a default under the Security Agreement if the medical practice has a judgment against it, and to collect the money from the accounts receivable to repay its debt before the unsecured (creditor without a lien) judgment holder pursues the medical practice assets.

Myth - Some doctors have been advised to obtain a line of credit and draw a nominal amount so that a lien can be recorded in the public records. Then they are led to believe that they might borrow large sums if they ever run into a creditor situation. By then it may be too late and the loan may be considered a fraudulent transfer.

Costs of Borrowing- If money is borrowed directly by the medical practice entity, and then paid out to the doctors, there will be a tax expense in most circumstances.

Our firm therefore feels strongly that clients approached with these techniques should first review other alternatives that may exist to protect their medical practice assets. There may be other collateral or guaranty techniques or arrangements that could be more protective and less expensive from an economic standpoint.

There are Other Solutions- While no choice is perfect, we are finding that plaintiff's lawyers are more willing to settle for policy limits when there are some resistant structures in place which blocks their access to furniture, equipment and accounts receivable. There are other techniques beyond those described above that can be considered for most client situations. Please contact our firm to learn more.

CHAPTER 21
THE PARTNERSHIP OF S CORPORATIONS MODEL

As mentioned above, many physician group practices are conducted under "partnership of S Corporation" arrangements whereby one LLC or limited liability partnership (LLP) owns and operates the group medical practice, and is in turn owned by two or more S Corporations, which are owned by the separate individual physicians who are "partners" in the practice. The author and many tax lawyers and CPAs prefer this type of arrangement to having multiple physicians directly owning medical practice entities for a number of reasons.

An important advantage is that this allows each separate physician to decide how their interest in the entity will be owned, what to take out as salary and dividends, whether to have a car and computers and other quasi-business assets held under their separate S corporation participating company, and what strategies to use as far as deducting payments for travel, entertainment, and other business activities. It also relieves medical practice entities from having responsibility for these types of decisions that would otherwise be made at the medical practice entity level.

For example, Drs. A, B and C would like to be partners in their medical practices, and would like to share income 80% based upon actual per doctor productivity and 20% based upon overall profits. They would also like to buy a CT scanner to be placed in a common office that they will be able to send their patients to for diagnosis.

Each of Drs. A, B and C form an S Corporation, PA, regular corporation, or LLC, and each of these three companies owns one-third (1/3) of "New Practice LLC," which is a limited liability company taxed as a partnership.

Each of these doctors and their respective employees goes to work for New Practice, LLC, and 80% of its profits are distributed to the S Corporation's pro rata to relative productivity between the three doctors.

Twenty percent (20%) is distributed equally. It is also important to make sure that the other Stark and Florida Patient Self-Referral Act laws are followed, including limitations on accepting referrals for diagnostic imaging from physicians outside the group practice, and having the CT scanner placed in an office where a doctor is available to supervise the technician and one or more of the doctors practices the full range of medicine in the same building.

To meet the Stark Law exceptions, it will be very important to make sure that profits from the technical component of the CT scanner are not distributed based upon referrals for CT, so the doctors have the CT scanner profits distributed 80% based upon patient visit productivity between the three doctors and 20% equally.

This is a typical "Partnership of PAs" or "Partnership of S Corporations" arrangement.

Each of Drs. A, B and C will have a separate checkbook under his or her respective medical practice PA and will be able to spend the monies received from the common partnership, LLC to pay for travel and entertainment expenses, a business automobile if desired, and for wages and dividends for the owner doctor based upon the advice of the doctor's personal CPA.

If there is a malpractice suit against one of the doctors for an act committed before the partnership arrangement was formed, then the lawsuit will be against the doctor individually and his previous practice entity, but not against the new partnership.

On the other hand, if and when there is a malpractice action filed for services rendered during the term of the partnership, the claim will usually be against the doctor, the common LLC entity, and the doctor's individual S Corporation entity as well. At this point the accounts receivable, furniture, and equipment owned by the partnership entity and assets owned by the doctor's individual S Corporation entity will be exposed.

This is a good reason that many group medical practice assets finance their furniture and equipment so that a bank will have a lien against these assets to make them less attractive to a potential malpractice claimant. The practice can also use the techniques previously described.

CHAPTER 22
A FABLE ON CREDITOR PROTECTION PLANNING FOR A GROUP MEDICAL PRACTICE

The following story has been used in multiple continuing education programs for lawyers and accountants and helps to describe the integrative use of a combination of common medical practice and investment entity creditor protection strategies that can be employed with the use of confident legal and accounting advisors.

Once upon a time, there was a medical group of doctors who individually owned their medical practice company.

The medical practice company had furniture, equipment, patient files, non-competition covenants enforceable against the doctors, and accounts receivable. The practice's accountant informed the practice that it would pay significant income taxes if it conveyed any of these assets outside of the practice company.

The practice was taxed as an S corporation.

The practice's lawyer attended a Florida Bar Seminar and learned about the "New Parent F Reorganization" that the authors began utilizing in 2007.

The practice entity was thereafter able to convey its equipment, furniture, and real estate out to separate limited liability companies owned by the new parent company without incurring federal income tax.

Such assets would therefore be free from potential claims of creditors who might emerge from future operations of the practice.

Such assets might also be protected from creditors whose claims arose before the transition, if the remaining practice entity and its accounts receivable and malpractice insurance would reasonably be expected to cover potential liability.

The practice's banker had concerns that the assumption of the mortgage on the practice's real estate and equipment by a new LLC owned by the new parent company might be subject to documentary stamp tax on the note, based upon 35¢ per $100.00 of indebtedness and intangible tax on the mortgage based upon 2/10 of 1% of the debt.

The banker was therefore not invited to the next two consecutive pharmaceutical-hosted holiday parties, and would thus never be called as a witness to any grand jury proceeding.

As part of the transition, the doctors who felt that they were permanently married learned that it would be advantageous to place their ownership in the new parent LLC into tenants by the entireties with their spouses.

They learned that a malpractice action against the owner doctor and the new subsidiary operating entity would probably not result in a judgment against the parent entity, nor against its ownership and equity associated with furniture, equipment, and real estate.

The married physicians also learned that their spouses would love them more if their spouses owned an equal share of the medical practice as tenants by the entireties. This reduced their family counseling fees greatly, exceeding the cost of legal fees associated with preparing new shareholder/member agreements to require the sale of practice entity interests to the physician's spouse in the incredibly small, tiny, and wholly unlikely event of a divorce.

The medical practice also had certain activities which were considered riskier than the main-stream practice activities, including mammogram services, laser hair removal, and brain surgery.

The practice learned that under the "Medical Practice Law", these activities could only be conducted under the practice entity or by a subsidiary of the practice entity, and therefore established a branch office specifically for these activities. This branch was operated by a subsidiary company owned 100% by the practice. Patients who used these services executed acknowledgments of the subsidiary's existence and operation, and thus were hopefully limited to pursuing assets of the subsidiary, and not the practice entity's accounts receivable or continuing identity and good will if they ever had a judgment against the subsidiary that provided them with the mammogram, laser hair removal, or brain surgery.

If the practice did not offer Designated Health Services ("DHS"), then certain practice activities could be conducted under a separate entity owned by the new parent company or owned completely separately by one or more of the physicians and their spouses in order to segregate liability. An example would be neurosurgeons who do not offer x-ray or any other designated health services who might operate their letter of protection expert work under one entity, while operating their high risk spinal and brain surgery practices under a separate entity that would not own or be associated with a letter of protection/expert practice.

"Oh giver of wonderful strategies", said the thankful physicians and their spouses (and spouses' divorce lawyers) "how might we preserve the accounts receivable associated with the historical parent entity?"

"I am glad you asked that question," said the wise lawyer. "You can borrow from the banker who recently aggravated you over documentary stamp taxes, pledging your accounts receivable as collateral thereon."

The certified public accountant responded that if the medical practice entity borrowed money and paid it out to the doctors, the doctors would have to pay income tax. This would accelerate the payment of tax on monies that the doctors would have eventually received. The doctors, after playing 18 holes of golf with their pharmaceutical representatives, firmly rejected the concept of paying tax on monies borrowed to protect their accounts receivable.

Then the worldly lawyer said, "Why not borrow the money personally, and let your medical practice guarantee the loan and pledge its accounts receivable as collateral. If it is done before there is a problem, the plaintiff will have a difficult time attaching your accounts receivable."

Thus, each doctor in the group was given the right to borrow money with credit enhancement provided by the accounts receivable of the practice, and with the practice guaranteeing the loans as an employee benefit, and pledging the accounts receivable as collateral.

Upon leaving the practice, each doctor would have to be able to use their share of accounts to repay the bank, and also would have to purchase tail malpractice insurance and pay income tax on the accounts receivable monies received.

Then said the insurance agents, whose endorsement of the overall arrangement was essential, "For the bank to make the loan, they need collateral above and beyond the accounts receivable - we can offer the doctors life insurance and annuity products which are creditor proof and which can be pledged to the bank to assure an advantageous loan rate, all while generating a commission for ourselves and our posterity."

Then said the banker, "We have sprinkled frankincense on all of the financial statements of all of the doctors, and find that out of the 10 of them 7 can borrow if their spouses guarantee, 2 are single and can borrow because of good credit, and 1 is a stinker and cannot borrow, but please don't tell him we said so."

Thus the doctor with a poor credit history purchased an annuity policy to be held in his name and pledged it to the bank as additional collateral for his loan. The other doctors borrowed independently without collateral other than the practice entity loan guaranties, and the pledging of the practice's valuable assets, including accounts receivable.

Thereafter, the doctors and their spouses invested the borrowed funds. Some invested in Google stock, others invested the money in beach condominiums, and a few smart-alecks invested in conservative stock and bond portfolios or mutual funds, contrary to popular advice.

The doctors further entered into a deferred compensation agreement, whereby their right to be paid from accounts receivable of the practice upon termination of employment or insolvency of the practice would be secured by a UCC-1 lien on the accounts receivable of the practice.

The doctors read the Florida Wage Statute at Section 222 to mean that such rights to payment were protected from creditors of the individual doctors, including malpractice claimants.

The doctors were made aware of certain bankruptcy court cases which, in the opinion of many worldly attorneys, would be overturned on appeal if they had been appealed.

And they all lived happily ever after.

CHAPTER 23
PROTECTING LETTERS OF PROTECTION AND ACCOUNTS RECEIVABLE – THE EXTENDED LETTER OF PROTECTION ENHANCEMENT SYSTEM ("ELOPE")

The Extended Letter of Protection Enhancement (ELOPE) System is a term and technique developed by our firm in 2007 that is especially useful for physicians who do injury victim work and are owed monies under Letters of Protection that are typically significant and are not paid for a number of years.

Many orthopedic surgeons, spine surgeons, and podiatrists have significant "personal injury" medical practices. Oftentimes, these doctors accept Letters of Protection for their services.

A Letter of Protection is a promise that the physician will be paid if and when the personal injury claim is settled. The law firm issuing the Letter of Protection basically agrees that the settlement or jury verdict judgment monies that would otherwise go to the plaintiff/patient will be paid to the doctor, to the extent delineated in the Letter of Protection.

Typically, the Letter of Protection charges are significantly higher than medical insurance, HMOs, or Medicare pay, which takes into account that the doctor has to wait a long time to be paid, and cannot be certain if or when he or she will be paid.

There is, therefore, a significant "Financial Leverage" occurring, as the doctor finances his practice while waiting to be paid sometimes as long as 2-3 years on average.

Besides the Financial Leverage issue, the value of the total of the Letters of Protection that a busy physician might be holding will often exceed $1,000,000. Those assets are subject to potential creditor claims of the medical practice.

The ELOPE System is designed to allow affiliated family entities, which may be owned by or for children, grandchildren, and other family members in lower tax brackets, to realize reasonable profits that would otherwise be taxed at the highest bracket possible, while also protecting the Letters of Protection from potential creditors of the medical practice and the physician.

It would make sense to immediately transfer Letters of Protection outside of the medical practice to an affiliated entity, but if the medical practice is taxed as a corporation, whether a regular corporation or an S corporation, the transfer of such Letters of Protection out to the doctor or any other entity affiliated with him or her will normally trigger taxable income on the value of the Letter of Protection at such time.

Therefore, the common idea of having a family limited partnership or other affiliated entity factor or purchase the Letters of Protection from the medical practice is typically not a popular one.

The solution under the ELOPE system is to have a factoring company established as a brother/sister company to the medical practice.

It is simple and inexpensive to establish a "New Parent S Corporation" to own 100% of the stock of the medical practice company and 100% of the stock of the factoring company. This new S corporation can be a Limited Liability Company that might be owned by the physician, the physician's spouse, or by the physician and the physician's spouse as Tenants by the Entireties.

The medical practice entity does not need to change its name, its taxpayer identification number, or any other significant aspect of its operations as a result of this "F Reorganization." Under the tax law it will be known as a Qualified Sub-Chapter S subsidiary ("Q-Sub").

One business purpose of this arrangement is to allow the affiliated family entity to be reasonably assured that the Letters of Protection that it finances the purchase of will not be lost to a malpractice claimant of the medical practice.

The monies received by the medical practice for the Letters of Protection may be held by the parent company for long term capital needs under an investment account. Unless or until the monies are paid out from the parent company, there should be no income tax thereon. The income from the Letters of Protection will therefore not have to be recognized until the ultimate payor (the patient or the insurance carrier) pays the Factoring Company for the Letter of Protection.

The Factoring Company may be administered by a separate S corporation that might be owned and run by the doctor's children. In that event, the Factoring Company would pay a reasonable management fee to the management S corporation, then the children might earn sufficient funds to fund their IRAs, and they also receive dividends to the extent that computer systems, policy and procedure manuals, and other physical and intangible assets of the management company cause income to be received.

The purpose accomplished from the point of view of the medical practice company and doctor is that income tax will not be triggered when the Letters of Protection are transferred to the Factoring Company, because transfers between a brother and sister company that are commonly owned by an S corporation parent can be disregarded for income tax purposes.

NOTE: A subsidiary company can elect to be treated as QSST (Qualified Sub-Chapter S Subsidiary). A new entity may elect to be treated as a Q-Sub or as a disregarded entity L.L.C., but may have a separate tax identification number. Each separate subsidiary should have separate financial statements, bank accounts, and fiscal conduct.

All income and deductions of the subsidiaries will go onto a single S corporation tax return for the parent company. However, it is crucial to keep separate books and records for each subsidiary, in order to maintain its independence and to avoid having a creditor of the medical practice assert that the Letter of Protection entity is an "alter ego" or "partner" of the medical practice.

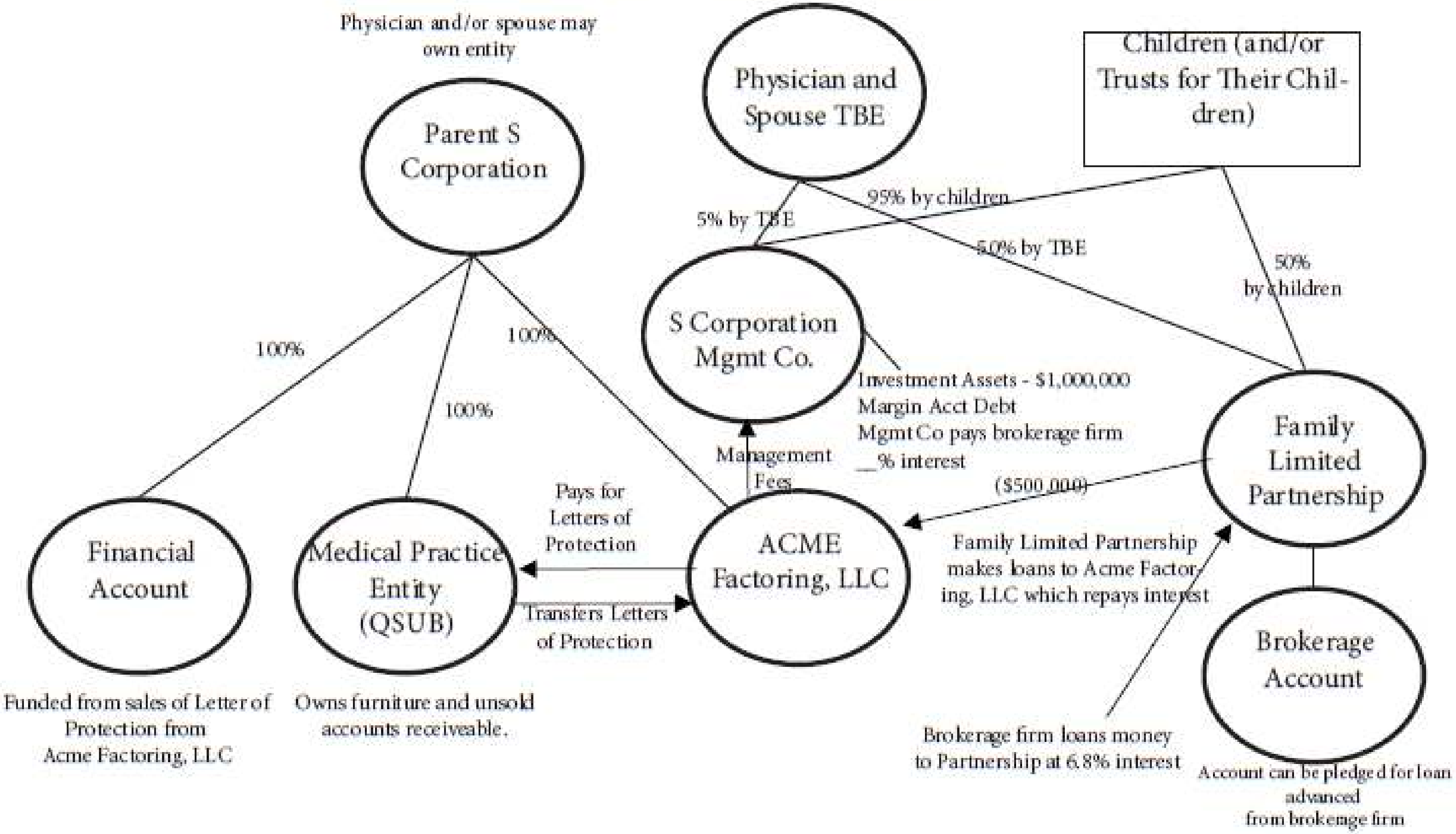
In our example, the Factoring Company would purchase Letters of Protection as they are received by the medical practice. At the end of each calendar month, the Letters of Protection received by the medical practice could be assigned to the Factoring Company, in exchange for which the Factoring Company could give the medical practice cash.

In order to allow an affiliated family entity to provide financial assistance to the medical practice and be paid reasonable compensation for such assistance, the applicable family limited partnership, S corporation, or trust established in whole or in part for the doctor's children, grandchildren, or other family members may have assets that can be pledged or otherwise collateralized to finance the Factoring Company. An example would be a family limited partnership with a $1,000,000 investment portfolio, which borrows money on margin from the brokerage firm at 6.8% interest and advances this money to the subsidiary Factoring Company. The Factoring Company then uses this money to purchase the pre-existing Letters of Protection that the medical practice owns, which may be valued at $400,000, based upon industry standards. The Letters of Protection may have a face amount of $1,000,000.

The market value of the Letters of Protection may be established by having arm's-length Factoring Companies review and make offers for the purchase or financing thereof. The Factoring Company can agree to pay a fairly high interest rate to the affiliated family company for the use of the money. The affiliated family company may be paying its brokerage firm 6.8% interest on the margin loan, and may be receiving 15% interest back from the Factoring Company. Some companies in this industry charge the highest percentage permitted by Florida law, which is 25% when the borrower is a corporation and the loan is in excess of $500,000. Where the loan is under $500,000, the usury rate under Florida Law is 18%. See Florida Statute 687.03.

EXTENDED LETTER OF PROTECTION ENHANCEMENT (ELOPE)

To enable a Family Limited Partnership and child-owned management entity to derive reasonable profits for the purchase and administration of letters of protection.



CHAPTER 24
BUY/SELL AGREEMENT ARRANGEMENTS

Buy/Sell Agreements are an essential component of creditor protection and wealth conservation planning for anyone who has partners or fellow shareholders in a significant practice or investment company.

This is discussed in Chapter 25 ("The Biggest Mistakes Doctors Make") under the category of Failure of Multiple Physician-Owned Practices to Have Appropriate Buy-Sell and/or Shareholder Agreements in Place.

Creditors can be prevented from taking over ownership of corporate interests, or may be bought out at a relatively low value, if Shareholder or Operating Agreements and ownership certificates are appropriately handled.

The design and implementation of Buy/Sell Agreements can also have a very significant impact upon creditor and wealth preservation planning, and we commonly see significant mistakes made in the design and drafting of such agreements and with respect to the ownership and maintenance of life insurance and disability buy-out insurance that has been purchased with hard earned money.

There are several different kinds of Buy/Sell Agreements for physician practices and investment arrangements, and these are commonly set forth in a "Shareholder Agreement", "Buy/Sell Agreement", or an "Operating Agreement". The terminology of the name or names of agreements that provide buy-in and buy-out arrangements vary significantly, and important provisions associated therewith may be found under corporate by-laws, employment agreements, severance pay agreements, and other legal documents.

A LOGICAL GUIDE TO SELECTING A BUY/SELL AGREEMENT ARRANGEMENTS

"A Logical Guide to Selecting a Buy/Sell Agreement Arrangement: Traditional Choices are Not Always the Best" written by Alan S. Gassman, Copyright © 2009

1. Entity Redemption Arrangements. The company owns the life insurance policy and is the beneficiary thereof. Upon receipt of the life insurance proceeds, the company is to use such proceeds to buy out the deceased owner.

Will there be enough money to (a) buy out the deceased owner and (b) have the deceased owner released from any and all guarantees and obligations associated with the business?

(a) If it is not practical to have the deceased owner released for contractual or other reasons, should the part of the life insurance proceeds that would otherwise be kept by the company as key man insurance be escrowed pending satisfaction or releases of any and all guarantees that the deceased owner may have responsibility for.

(b) How can the deceased owner's family be sure that the monies received from the life insurance policy will actually be used to satisfy contractual buy-out agreements?

(c) What if the company claims that for some reason the agreement is not enforceable or that there are claims against the deceased owner that offset what would be paid to him or her?

(d) What if the company has a major creditor claim against it (what if the deceased owner died in a car accident that he or she caused while driving a company vehicle and the company is now being sued by others who died in the accident?)

(e) What if the company goes into bankruptcy and the family of the deceased owner becomes just another creditor in a bankruptcy proceeding?

(f) For income tax purposes the remaining shareholders do not get a stepped up basis for the stock purchased. The stock simply becomes treasury stock.

2. Cross Purchase Agreements can be considered to avoid the above potential problems.

Each owner may own the policy or policies on the other owners. Thus the policy proceeds should be protected from creditors of the company.

Also, each purchasing shareholder will get a tax basis in the purchased stock equal to the purchase price thereof.

(a) However, policy proceeds will not be protected from creditors of the surviving owner who would receive policy proceeds.

(b) Also, contractual disputes could result in the surviving owner using the funds for other purposes while litigating over the obligation to pay and becoming insolvent.

(c) Further if there are more than 2 shareholders, then on the death of one owner the policies owned on the others would need to be transferred to rebalance between them, thus causing issues under the transfer for value rules. For example, if there are 4 equal shareholders there have to be 4 polices each owned 1/3rd each by each 3 shareholders on the fourth, and if one leaves the company the remaining 3 policies have to be readjusted as to ownership. Under the transfer for value rules this could cause the proceeds of a life insurance policy to be subject to income tax when the insured person dies.

3. Hybrids of the Above Types of Agreements.

Consider a Trusteed Corporate or Cross-Purchase Agreement. Under these arrangements the owner and beneficiary of the policy can be a trust company, a law firm, or another trusted institution as trustee for the benefit of the company in a Trusteed Redemption arrangement, or for the benefit of the other shareholder or shareholders in a Trusteed Cross-Purchase arrangement. The trust agreement can require that the policy proceeds be held safely until sale and used solely for redemption or cross-purchase purposes. This at least assures the surviving family that the life insurance proceeds will not be absconded with.

Generally for tax purposes the policy needs to be considered as owned and payable to the company in a redemption arrangement, or to the surviving owner or owners in a cross-purchase agreement. Could a state court or a bankruptcy court override the trust agreement where there are creditors of the entity in a redemption arrangement, or creditors of the remaining shareholders in a cross-purchase arrangement?

There would be a purchase price tax basis for the other shareholders if the Trustee is appropriately characterized as an agent for the other shareholders.

4. The Optimal Solution: Use of a Related Partnership to Facilitate Purchase.

Because of the above concerns, oftentimes a separate limited partnership or limited liability company is established to own and facilitate the life insurance buy-out arrangement.

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CHAPTER 25
THE BIGGEST MISTAKES DOCTORS MAKE

The foregoing pages of this book are designed to show you how to protect you your family and your medical practice. Now we can talk about the biggest mistakes that doctors make, and how to avoid them so that you have assets to protect. You can read on to see what mistakes you may have already made, and what mistakes you can avoid making going forwards.

THE BIGGEST MISTAKES DOCTORS MAKE:

1. Failure to Maintain and Appropriately Use Independent Professional Advisors. We already discussed finding an appropriately qualified lawyer for your asset protection and estate planning, but your arsenal of advisors should extend beyond your lawyer. Many of the calamities described below will be avoided if a medical practice has experienced advisors on board. The practice should consult with its advisors when making major practice decisions, and also periodically confirm that appropriate procedures and safeguards are in place.

   (a) CPA: Quite often the quarterback of the advisor team will be a good, caring Certified Public Accountant who does extensive medical practice work. CPAs are often well versed in investments, business matters, and methods of financially theft-proofing a medical practice.

   CPAs should prepare quarterly or monthly financial statements for the medical practice; these statements should involve a review of accounts receivable, cash flow and general practice financial information.

   (b) Attorney: An experienced lawyer who represents a number of medical practices should have sufficient experience to help physicians avoid terrible problems before they occur.

   Just as physicians advise patients to have an annual check-up, a medical practice client should confer with his or her lawyer on a periodic basis. Commonly the primary lawyer for the practice will refer matters to appropriate sub-specialist attorneys in a number of different areas. Often this happens in conjunction with a CPA meeting.

   (c) Other Advisors: Other advisors commonly and appropriately used by a medical practice group will include (i) a qualified pension plan advisor, who is also preferably an actuary, as well as (ii) a banker who is knowledgeable as to practical business expense and loan-associated planning, and (iii) a reputable and conservative financial advisor or advisors who assist with pension planning, various insurances, and other practice-associated financial instruments.

Good advisors should be honest and always let the physician and the rest of the team know about questions, concerns, or the need to bring in additional experts to handle any particular matter or situation. Advisors who show up to sell only a single product or scheme often cause problems.

2. Failure to Maintain Medical Law Compliance. A great many physicians are annihilated financially when Medicare and/or private insurance carriers request hundreds of thousands of dollars in refunds because the physician has used inappropriate billing practices or financial arrangements with third parties. In many cases, these problems are reported to the government by employees who can earn a 15% "whistle-blower fee."

Many physician clients simply do not realize they are using improper coding, do not maintain sufficient patient file back-up, or bill for items that are inappropriately unbundled or altogether un-billable.

Reasonable and periodic practice maintenance and review by trusted medical consultant advisors eliminates the need for a more costly venture, such as a medical practice audit. In the author's experience, most medical practices benefit from hiring an independent consultant to come into the practice, perhaps annually, to spend a day randomly reviewing patient charts and the billing and collection processes associated therewith.

Quite often, a good consultant can spot billing opportunities where the practice is undercharging or not charging at all for certain services. An independent consultant can also be a tactful go-between in conveying to some medical practice members that their file documentation is not sufficient. Such corrections are best conveyed by a neutral third party.

Consultants should be hired by a lawyer on behalf of the medical practices, so that any problems discovered can stay confidential under the attorney-client privilege to the extent possible.

If and when the government criticizes a medical practice's coding, file documentation or other billing procedures, it is very helpful to be able to show that the practice conscientiously hired and followed the advice of a reputable billing and coding consultant on a periodic basis.

Many physician groups are also unfamiliar with or intentionally disregard rules relating to arm's-length leases, compensation arrangements, and referrals or testing within a group medical practice. The author has had law-abiding and well-meaning physician clients arrested in their lobbies by the FBI as a result of being in business with the wrong people at the wrong time.

Doctors can rest assured that any "scoundrel" that they have legitimate or questionable business relationships with will turn them in to get amnesty if and when approached by law enforcement, even if the doctor did nothing wrong. When law enforcement comes knocking the doctor should immediately have appropriate sub-specialty lawyers contact law enforcement on his or her behalf. Neither the doctor nor his or her staff should directly speak with any law enforcement officers at any time on any topic.

3. Failure to Maintain Proper Malpractice Insurance. While malpractice insurance is not inexpensive, it is necessary in order to protect physicians from the significant legal fees, expert witness costs, and liability exposure associated with defending lawsuits. The proliferation of the personal injury lawyer industry shows no sign of slowing down, and a sympathetic jury system, coupled with experts willing to testify that a doctor committed malpractice under complicated circumstances that a jury can never understand provides good cause for maintaining appropriate malpractice insurance coverage.

Many advisors and clients believe that a practice need only maintain the lowest limits of liability coverage because "they will always settle for your limits," but we have already discussed the essential rashness and untruth of such a statement in earlier sections. The authors advise physician clients to have higher levels of liability insurance than the legally required minimum.

Many physicians will obtain malpractice insurance coverage from low-cost carriers that turn out to be infirm and go bankrupt, leaving doctors high and dry to defend their own claims and without any coverage whatsoever for legal and expert expenses. Therefore, any opportunity to pay significantly less than the going rate for malpractice coverage should be reviewed carefully.

Also, the income tax laws permit a medical group to form its own "captive insurance carrier" and deduct premiums paid to the carrier company. Under the tax law, the carrier company may not have to include premiums received as income unless or until it is determined what portion of the premiums will be used to pay claims as expenses and what portion of the premiums will be profits. Profits taken out later may be taxed at favorable capital gains rates.

Nevertheless, this is a significant economic risk, since the carrier could "go under" if there are extensive claims, and when there are multiple doctors being insured by the carrier, one or two doctors who make a lot of mistakes could cost all of the equity for the other doctors.

Further, unlike conventional malpractice insurance, which requires a carrier to offer tail malpractice insurance coverage at the request of each doctor, captive insurance carrier reinsurance contracts may not bind the reinsurance company to renew the coverage, let alone provide a tail policy on termination, leaving an entire group of doctors without any coverage whatsoever. Successor carriers will not provide tail coverage for periods of time when no other carrier is on the hook.

We have also discussed the dangers of "going bare", which can occur when a doctor has malpractice insurance provided by a carrier who is not state-registered. A possible loss of license can occur if a doctor cannot satisfy a claim by reason of not having malpractice insurance or the financial wherewithal to pay a claim.

Many doctors are not aware that for a small additional premium, they can have a separate "corporate" malpractice insurance policy issued by the same carrier that provides individual policies that covers the medical practice company. This effectively doubles the limits of malpractice insurance that would be available to pay on a claim, and assures that the company will have coverage if one of the doctors leaves and refuses to buy tail malpractice insurance.

Furthermore, nurse practitioners and registered nurses can often qualify for insurance with high limits of liability for very low cost. Many physicians will not treat certain types of high-risk patients unless they at all times have a nurse practitioner in the room with them to make sure that there is plenty of coverage, witnesses to what is said, and appropriate follow-up.

4. Failure of Multiple Physician-Owned Practices to Have Appropriate Buy/Sell and/or Shareholder Agreements in Place. Many successful medical practices are run on a handshake or a long-forgotten and now archaic agreement, but when problems or changes in circumstances arise the results can be catastrophic for the physicians - though quite lucrative for the legal profession.

Example: Doctor A and Doctor B are lifelong friends who have practiced together 25 years and share 50% each ownership of a medical practice without current legal agreements. Their spouses have also been best friends.

They have always worked approximately the same and have always been paid the same. A couple of years ago they were offered $3,000,000 for the practice, which involved signing 5 year non-competes and 5-year employment agreements. They also own the practice real estate together in a separate company under which they have signed a $2,000,000 mortgage on real estate now worth only $1,500,000.

If Doctor A becomes disabled, they may not be able to agree on how much Doctor B should be paid to administer the practice. Disagreements may also arise regarding the hiring of a replacement doctor or doctors.

They may also not be able to agree on a price or terms for Doctor B to buy Doctor A out.

Often disabled or injured physicians believe they may be able to return to work. Meanwhile, their partners take a more cautious view of their capacity for recovery. The practice can be significantly damaged during this period of time until the disabled physician's status on returning to work is absolutely confirmed.

What if Doctor A is faced with drug addiction or begins having an affair with medical practice personnel that could cause obliteration of the practice? How can Doctor B force Doctor A to leave, or to even behave? How can Doctor B protect the practice and himself from responsibility for Doctor A's difficulties?

What if Doctor A dies? Doctor A's widow may believe that the practice is worth $3,000,000 and will be voting Doctor A's stock unless or until she is bought out. How can Doctor B convince Doctor A's widow and her lawyers and valuation experts that the practice has lost significant value because of Doctor A's death? How can Doctor B run the practice, if Doctor A's widow will not agree to any significant changes in situations where such changes become necessary?

How can Doctor B attract a new doctor to the practice if he has to disclose that he is not getting along with the 50% widow owner of the practice?

The list of examples goes on and on. It does take time and money to put together an appropriate Buy-Sell/Employment/Shareholder document package. Almost no two are the same as circumstances change. However, it is a valuable investment that every practice should make.

In addition, applicable state law and/or Medicare law often requires that compensation be based upon methods determined in advance that do not take into account the referral of patient services. As mentioned under number 2 above, the referral of a patient within a group practice for certain testing or other "designated health services" under the Stark Law can be a felony unless there is a properly documented method of sharing that qualifies under the Stark Laws. Failure to have this in writing in advance of a particular calendar quarter can constitute a felony offense.

5. Failure to Procure and Maintain Proper Insurances. There are myriad insurances required to appropriately safeguard a medical practices from the normal risks of doing business, particularly in view of the American trial system.

Fortunately most of these risks can be reasonably handled on an affordable basis, assuming that proper coverage is in place.

The most important coverage is clearly malpractice insurance, which we have already addressed, and which is mentioned below as a separate section, but other insurances which are essential to the well-being of physicians and their medical practices include:

(a) Disability insurance;

(b) Overhead insurance to handle practice expenses during a period of disability or in the event of a natural disaster such as a hurricane or acts of terrorism;

(c) Liability insurance to cover non-malpractice obligations, such as if patients or others hurt themselves in the parking lot or fall on slippery areas in the office;

(d) Workers' compensation insurance to protect the practice against state laws that can require lifetime support and/or significant monetary payments to be made to an employee injured in the course of employment; and

(e) Unowned automobile liability insurance to insure against the liability that occurs to a medical practice if any employee is in an automobile accident while running errands or otherwise working in the course of medical practice business.

We have also discussed the risks of inadequate automobile liability coverage; the authors typically recommend at least $3,000,000 - $5,000,000 worth of umbrella liability coverage to cover all business and personal driving, and driving by others who might use the doctor's car.

There are thousands of disabled physicians in the United States now living on disability insurance. The author has more than 15 clients who have been able to "retire" on their disability insurance. This explains why the rates are so high to procure such coverage, but also why having good coverage is a necessity rather than a luxury for physicians who do not have adequate retirement savings to support themselves and their families for their remaining lifetimes.

Sometimes individual health insurance policies will not cover on-the-job injuries, under the presumption that a doctor will be covered under workers' compensation for on-the-job injuries. Doctors who do not have workers' compensation insurance, which is often waived to save money, should check their health insurance policies to make sure that they are covered for on-the-job injuries.

6. Failure to Make the Medical Practice and the Doctor Judgment-Proof. We have extensively discussed how to protect a medical practice and its assets; failure to do so can be devastating to a doctor and his or her family. There are many ways that a medical practice and a doctor can work to make themselves a less attractive target for a plaintiff's lawyer.

Often the practice incurs debt in its name, and the lender or lenders have liens on practice and personal assets that must be paid before a plaintiff is able to levy upon a doctor or practice. Also, valuable assets like real estate and furniture and equipment can be owned by a separate entity that would lease those assets to the medical practice to make them inaccessible, or at least less accessible, to a malpractice claimant.

It is also important to ensure that each physician in a group has his or her personal creditor protection planning properly in place so that a plaintiff lawyer can be led to settle within policy limits if and when a catastrophic lawsuit occurs.

Because of state and bankruptcy law fraudulent transfer law statutes, it is often crucial that creditor protection planning for the medical practice entity and the doctors occur well before any problems arise.

When a serious lawsuit occurs, the doctors should keep in mind that the lawyer hired by the insurance company does not necessarily have duty of absolute loyalty to the doctor. The malpractice insurance carrier selects and pays the lawyer.

There are often circumstances whereby an independent lawyer should be hired by the doctor to encourage the insurance carrier to settle a claim within policy limits when the opportunity arises, in order not to risk the doctor's personal and practice assets to an "excess verdict." We have also discussed the "bad faith" rules, under which many states have laws that will require an insurance carrier to be responsible for any excess verdict, if proper demand has been made upon the carrier when it had the opportunity to settle within policy limits.

7. Failure to Theft-Proof the Practice's Monies and Accounts Receivable. The author regularly receives at least one phone call per year from a very upset physician who has had tens of thousands of practice dollars stolen by an employee. This employee has often been with the practice many years, and most of the time is the most trusted person in the practice other than the physicians themselves. As such, the employee is able to obtain physical possession of checks made payable to the practice by one or more payor sources and/or has written checks on the practice accounts for bogus expenses.

Over the years, we have seen medical practices unwillingly and unwittingly pay credit card expenses, electric company expenses, car payments, and even home mortgage payments for a medical practice employee. When the circumstances are reviewed, they reveal that most of these situations would have been avoidable with proper supervision and use of appropriate safeguards.

Additionally, money is often stolen from practice accounts when large projects such as buildings, construction, or similar matters are administered by a person who signs the checks and/or administers the checks and invoices for a busy physician.

Most of the time the theft is carried out by a trusted office manager, without any assistance from another employee.

It is a very basic accounting system principle that the person or people who physically open the envelopes containing checks payable to the practice record the checks onto a log and ensure that the checks are properly deposited. These deposits are then reported to a separate employee who has the ability to record the payments in the practice's computer system.

It is a fatal error to allow one individual to have physical possession of checks and also the ability to enter payments or write-offs onto the practice's billing computer system. Even spouses have been known to steal from medical practices, especially when the practice has multiple partners.

Many practices use a post office box for checks to eliminate the risk of someone being able to "snatch a few checks from the mail" before they can be posted. Many banks offer check-depositing services and addresses that can be used as well. These are often known as "lock box" arrangements.

Larger practices can have someone from their CPA firm visit the practice on an annual basis without advance notice to the practice personnel. This demonstrates to employees that there is some degree of monitoring, and can discourage practice theft.

8. Using Greedy Investment Advisors. The number of different investments and life insurance and annuity arrangements that can be sold to doctors and their practices in the financial world is limitless, and growing! The quality of each particular investment vehicle can vary dramatically in terms of actual financial safety, conservative versus aggressive orientation, likelihood of being acceptable to the IRS in the event of an audit, and the amount of commission paid to advisors who may suggest such arrangements.

Expecting a physician to read a prospectus or to understand a complicated tax maneuver is like expecting a lawyer or a CPA to read an EKG- it is easy to be mistaken!

If the advisors are earning a significant portion of the amounts invested as compensation, a degree of manipulation, non-disclosure, exaggeration or outright lying can take place.

In the pension world, actuaries and many CPA firms who practice extensively in the retirement plan arena can yield great results for clients. Pension and profit-sharing plans are well-protected under applicable creditor laws and well-accepted under the tax law in conventional form.

More aggressive plans, such as 419A Welfare Benefit plans and 412i plans, should be examined carefully by independent advisors before investing.

The author urges clients to use independent accountants who are not compensated directly or indirectly for the sale of financial products. The author has seen entire fortunes lost to tax shelter deals in the 1970s, leveraged real estate deals in the 1980s, land development deals in the 1990s, and now Madoff and related Ponzi and margined-securities deals in recent years. Crime often pays, and the victim is the doctor who gets involved in these types of arrangements.

There is rarely a good reason for a pension or profit-sharing plan to own a life insurance or annuity product, except to compensate anyone who may be licensed in life insurance and annuities who has involvement in the pension or profit-sharing

9. Unbalanced Investment Portfolios. Statistical studies show that a diversified portfolio of investments will generally out perform a non-diversified portfolio, with significantly less risk. Many successful clients own investment real estate, mutual funds allocated among the various classes of stock investments, and bond funds or CDs. It almost never makes sense for anyone to put all of their eggs in one basket.

Go for singles and doubles instead of home runs. Time and time again we have seen physicians place significant portions of their financial assets into high risk investments or ventures with the intention of hitting "a home run" under risky circumstances. In our experience, these clients almost always strike out. Many end up working full time into their 70s, and eventually retire only by selling their home and living in an apartment.

There is almost always a direct and opposite correlation between expected rate of return and risk being taken. Many high income professionals recognize this and are nevertheless willing to take risks. Quite often, however, physician investors are assured that an arrangement is "virtually risk free" even though it is expected (or touted) to yield a significant return. If it seems too good to be true, it probably is.

10. Doing Business with the Wrong People. Unfortunately, crime, and also deceitful or misleading behavior can be lucrative for the "bad apple", and these individuals are often found courting doctors to do business and investment transactions or to provide consulting services.

Since the overwhelming majority of doctors are very honest and do not have formal business training, it is not difficult to market "unique propositions" to doctors and to eventually find a handful of doctors who may succumb to participate in a recommended arrangement.

Commonly these "bad apples" will present themselves through relatives, friends and possibly even misled advisors.

Typically the doctor will be asked to invest in a startup or growing company, to help start a new business, or to be involved in the purchasing or financing of real estate.

Bad apples are often well-dressed, exhibit success in the forms of nice house and cars, and sometimes even jet airplanes, stunning vacations, trophy wives, and impressive club memberships.

A team of advisors can usually sniff out this type of individual or organization by checking references, or the lack thereof, licensing, and with other professionals who have worked with the applicable individual. The author has seen these characters in billing companies, unique invention startups, real estate ventures, medical related companies, ice machines (that did not exist), Ponzi schemes, and other situations.

Do not forget the adage about the experienced businessman and the doctor who become partners. The businessman puts in his experience and the doctor puts in his money. At the end of the day the businessman has the money and the doctor merely has an experience!

Doctors with gambling addiction tendencies are often drawn to elusive schemes where the doctor is told that he or she has earned millions of dollars and should have colleagues put money in so that they can earn millions too, while in reality the "con job" is that the money is being stolen or used to pay debts on assets that will never be worth anything. A junior Madoff may be your next door neighbor or brother-in-law!

Every year the IRS publishes the "Dirty Dozen," a list of tax frauds, including schemes involving the internet, domestic tax crimes, offshore frauds and false claims for refunds. This is done for the benefit of citizens and their awareness of financial predators. The IRS website at http://www.irs.gov/newsroom/article/0,id=206370,00.html says it right: "Taxpayers should be wary of scams to avoid paying taxes that seem too good to be true, especially during these challenging economic times," Commissioner Doug Shulman said. "There is no secret trick that can eliminate a person's tax obligations. People should be wary of anyone peddling any of these scams."

11. Failure to Have Anyone in the Practice Pay Attention to Contracts with Third Parties. Quite often medical practices get into disputes or find themselves stuck in agreements as a result of a trusting nature or lack of attention to details associated with contracts they enter into with third parties. Say, for example, somebody delivers a copier to the medical practice that the office manager has requested on a trial basis. Upon delivery, that person gets the receptionist to sign a contract accepting copier and binding the practice to 48 months of payments.

Another example is when a medical practice has a lease that gives the doctors the right to extend after a certain date, but they forget to give notice of extension by the deadline. The practice gets held up by the landlord for a larger rent payment or has to vacate and find new property.

A third example is when a lease for a large piece of equipment also requires the practice to maintain the equipment with one company only. The company may provide poor service or may not permit the practice to pre-pay the lease or refinance it from a high rate of interest without paying tens of thousands of dollars in penalties.

Another trap some practices fall into is using an office manager or non-CPA accountant to draft legal documents that employ physicians, or to set up companies for the practice, not realizing that the contracts have inappropriate provisions or do not cover essential items that a lawyer or appropriately qualified advisor would have pointed out.

F. Lee Bailey, a famous criminal defense lawyer, said that "anyone who acts as his own lawyer has a fool for a client." Most successful lawyers hire other lawyers to do work for them personally when it is outside of their area of specialty, or sometimes even when it is within their area of specialty because of this phenomenon.

THE BUSINESS OF MEDICINE: LEGAL STRUCTURES AND TAXATION

Saturday, January 6, 2024

From 11:00 AM to 12:00 PM EST

(60 minutes)

Presented By:

Lynda Dilts-Benson, RN, CCM, LHRM, CRC

Pariksith Singh, M.D.

Alan Gassman, JD, LL.M. (Taxation), AEP® (Distinguished)
agassman@gassmanpa.com

THE BIGGEST MISTAKES THAT DOCTORS MAKE WITH RESPECT TO MANAGING THEIR MEDICAL PRACTICES AND INVESTMENTS

By Alan S. Gassman, J.D., LL.M.

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Alan Gassman, a partner in Gassman, Bates & Associates, P.A., and a frequent LISI commentator, has represented several hundred medical practices through the years. Alan practices business, estate planning and tax law in Clearwater, Florida.

A thriving and successful medical practice can quickly be pulled under by one catastrophic incident that destroys its financial solvency, its credibility, or both. How and why do such catastrophes occur, and what are their most common forms?

EXECUTIVE SUMMARY:

This commentary reviews ten avoidable mistakes that can be the cause of fatal errors for medical practices and investment portfolios.

COMMENT:

While different physicians and groups of physicians tend to make more mistakes in one area than another, each common mistake area should be reviewed and understood with appropriate advisors. These common errors, which are described in more detail below, are as follows:

1. **Failure to Maintain and Appropriately Use Independent Professional Advisors.**
2. **Failure to Maintain Medical Law Compliance.**
3. **Failure to Maintain Proper Malpractice Insurance.**
4. **Failure of Multiple Physician-Owned Practices to Have Appropriate Buy-Sell and/or Shareholder Agreements in place.**
5. **Failure to Procure and Maintain Proper Insurances.**
6. **Failure to Make the Medical Practice and Doctor Judgment-Proof.**
7. **Failure to Theft-Proof the Practice's Monies and Accounts Receivable.**
8. **Using Greedy Investment Advisors.**
9. **Unbalanced Investment Portfolio.**
10. **Doing Business With the Wrong People.**
11. **Failure to Have Anyone in the Practice Pay Attention to Contracts with Third Parties.**

1. Failure to Maintain and Appropriately Use Independent Professional Advisors. Many of the calamities described below will be avoided if a medical practice has experienced advisors on board. The practice should consult with its advisors when making major practice decisions, and also periodically confirm that appropriate procedures and safeguards are in place.

(a) CPA: Quite often the quarterback of the advisor team will be a good, caring Certified Public Accountant who does extensive medical practice work. CPA's are often well versed in investments, business matters, and methods of theft- proofing a medical practice from a financial standpoint.

CPAs should prepare quarterly or monthly financial statements for the medical practice; these statements should involve a review of accounts receivable, cash flow and general practice financial information.

(b) Attorney: An experienced lawyer who represents a number of medical practices should have sufficient experience to help physicians avoid terrible problems before they occur.

Just as physicians advise patients to have an annual check-up, and may wisely require this before prescriptions are renewed beyond 12 months, a medical practice client should confer with its lawyer on a periodic basis. Commonly the primary lawyer for the practice will refer matters to appropriate sub-specialist attorneys in a number of different areas. Often this happens in conjunction with a CPA meeting.

(c) Other Advisors: Other advisors commonly and appropriately used by a medical practice group will include (i) a qualified pension plan advisor, who is also preferably an actuary, as well as (ii) a banker who is knowledgeable as to practical business expense and loan-associated planning, and (iii) a reputable and conservative financial advisor or advisors who assist with pension planning, various insurances, and other practice-associated financial instruments.

Good advisors should be honest and always let the physician and the rest of the team know about questions, concerns, or the need to bring in additional experts to handle any particular matter or situation. Advisors who show up to sell a single product or scheme commonly cause problems, as described in below.

2. Failure to Maintain Medical Law Compliance. A great many physicians are annihilated financially when Medicare and/or private insurance carriers request hundreds of thousands of dollars in refunds because the physician has used inappropriate billing practices or financial arrangements with third parties. In many cases these problems are reported to the government by employees who can earn a 15% "whistle-blower fee."

Many physician clients simply do not realize that they use improper coding, do not maintain sufficient patient file back-up, or bill for items that are inappropriately unbundled or altogether un-billable.

Several years ago, the concept of a "medical practice compliance audit" was in vogue, and many professionals, in the opinion of the author, significantly over-charged physician groups for "practice audits." Such audits extended far beyond a reasonable review of billing, patient file documentation, and third-party financial arrangement review.

Reasonable and periodic practice maintenance and reviewed by trusted medical consultant advisors eliminates the need for such a costly venture. In the author's experience, most medical practices benefit from hiring an independent consultant to come into the practice, perhaps annually, to spend a day randomly reviewing patient charts and the billing and collection processes associated therewith.

Quite often a good consultant can spot billing opportunities where the practice is undercharging or not knowing to charge for certain services. An independent consultant can also be a tactful go-between to let certain members of a medical practice know that their file documentation is not sufficient. Such corrections are best conveyed by a neutral third party.

Consultants should be hired by a lawyer on behalf of the medical practice so that any problems they may discover can stay confidential under the attorney-client privilege to the extent possible.

If and when the government criticizes a medical practice's coding, file documentation or other billing procedures, it is very helpful to be able to show that the practice conscientiously hired and followed the advice of a reputable billing and coding consultant on a periodic basis.

Many physician groups are also unfamiliar with or intentionally disregard rules relating to arms length leases, compensation arrangements, and also the ability to refer tests within a group medical practice only if certain rules are followed. The author has had law-abiding and well-meaning physician clients arrested in their lobbies by the FBI as a result of being in business with the wrong people at the wrong time.

Doctors can rest assured that any "scoundrel" that they have legitimate or questionable business relationships with will turn them in to get amnesty if and when approached by law enforcement, even if the doctor did nothing wrong. When law enforcement comes knocking the doctor should immediately have appropriate sub-specialty lawyers contact law enforcement on his or her behalf. Neither the doctor nor his or her staff should directly speak with any law enforcement officers at any time on any topic.

3. <u>Failure to Maintain Proper Malpractice Insurance. While malpractice insurance is not inexpensive, it is necessary in order to protect physicians from the significant legal fees, expert witness costs, and liability exposure associated with defending lawsuits. The proliferation of the personal injury lawyer industry shows no sign of slowing down, and a sympathetic jury system, coupled with experts willing to testify that a doctor committed malpractice under complicated circumstances that a jury can never understand provides good cause for maintaining appropriate malpractice insurance coverage.</u>

Many advisors and clients believe that a practice need only maintain the lowest limits of liability coverage because "they will always settle for your limits," but the author has found that in many cases plaintiffs will not settle for low limits of medical malpractice insurance liability where there are other significant assets exposed. Physician clients will sleep better and have a greater sense of financial security, as well as significantly less personal exposure, when they have higher levels of liability insurance than the legally required minimum.

Many physicians will obtain malpractice insurance coverage from low-cost carriers that turn out to be infirm and go bankrupt, leaving doctors high and dry to defend their own claims and without any coverage whatsoever for legal and expert expenses.

Any opportunity to pay significantly less than the going rate for malpractice coverage should be reviewed carefully with the above concerns in mind.

Also, the income tax laws permit a medical group to form its own "captive insurance carrier" and deduct premiums paid to the carrier company. Under the tax law the carrier company may not have to include premiums received as income unless or until it is determined what portion of the premiums will be used to pay claims as expenses and what portion of the premiums will be profits. Profits taken out later may be taxed at favorable capital gains rates.

Nevertheless, there is a significant economic risk taken since the carrier could "go under" if there are extensive claims, and when there are multiple doctors being insured by the carrier, one or two doctors who make a lot of mistakes could cost all of the equity for the other doctors.

Further, unlike conventional malpractice insurance, which requires a carrier to offer tail malpractice insurance coverage at the request of each doctor, captive insurance carrier reinsurance contracts will commonly not bind the reinsurance company to even renew the coverage, let alone provide a tail policy on termination, leaving an entire group of doctors without any coverage whatsoever. Successor carriers will not provide tail coverage for periods of time that no other carrier is on the hook for.

The laws of most states require that malpractice insurance be provided by a state-registered carrier. Doctors who have malpractice insurance furnished by an unregistered carrier may be considered to be "going bare" under state law, and may therefore have to notify patients that the doctor is "bare." A possible loss of license can occur if a doctor cannot satisfy a claim by reason of not having malpractice insurance or the financial wherewithal to pay a claim.

Many doctors are not aware that for a small additional premium they can have a separate "corporate" malpractice insurance policy issued by the same carrier that provides individual policies that covers the medical practice company in order to effectively double the limits of malpractice insurance that would be available to pay on a claim, and to assure that the company will have coverage if one of the doctors leaves and refuses to buy tail malpractice insurance.

Also, nurse practitioners and registered nurses can often qualify for insurance with high limits of liability for very low cost. Many physicians will not treat certain types of high-risk patients unless they at all times have a nurse practitioner in the room with them to make sure that there is plenty of coverage, witnesses to what is said, and appropriate follow-up.

4. <u>Failure of Multiple Physician-Owned Practices to Have Appropriate Buy-Sell and/or Shareholder Agreements in Place. Many successful medical practices are run on a handshake or a long-forgotten and now archaic agreement, but when problems or changes in circumstances arise the results can be catastrophic- and quite lucrative for the legal profession.</u>

For the sake of example, assume that Doctor A and Doctor B are lifelong friends who have practiced together 25 years and share 50% each ownership of a medical practice without current legal agreements. Their spouses have also been best friends.

They have always worked approximately the same and have always been paid the same. A couple of years ago they were offered $3,000,000 for the practice, which involved signing 5 year non-competes and 5-year employment agreements. They also own the practice real estate together in a separate company under which they have signed a $2,000,000 mortgage on real estate now worth only $1,500,000.

If Doctor A becomes disabled, they may not be able to agree on how much Doctor B should be paid to administer the practice. Disagreements may also arise regarding the hiring of a replacement doctor or doctors.

They may also not be able to agree on a price or terms for Doctor B to buy Doctor A out.

Often disabled physicians believe they will be returning to work. Meanwhile, their partners see the writing on the wall and take a more skeptical view of their capacity for recovery. The practice can be significantly damaged during this period of time until the disabled physician's status on returning to work is absolutely confirmed.

What if Doctor A becomes a drug addict or begins having an affair with medical practice personnel that could cause obliteration of the practice? How can Doctor B force Doctor A to leave, or to even behave? How can Doctor B protect the practice and himself from responsibility for Doctor A's misconduct?

What if Doctor A dies? Doctor A's widow may believe that the practice is worth $3,000,000 and will be voting Doctor A's stock unless or until she is bought out. How can Doctor B convince Doctor A and her lawyers and valuation experts that the practice has lost significant value because of Doctor A's death? How can Doctor B run the practice if Doctor A's widow will not agree to any significant changes in situations where such changes become necessary?

How can Doctor B attract a new doctor to the practice if he has to disclose that he is not getting along with the 50% widow owner of the practice?

The list of examples goes on and on. It does take time and money to put together an appropriate Buy-Sell/Employment/Shareholder document package. Almost no two are the same as circumstances change. However, it is a valuable investment that every practice should make.

In addition, applicable state law and/or Medicare law often requires that compensation be based upon methods determined in advance that do not take into account the referral of patient services. As mentioned under number 2 above, the referral of a patient within a group practice for certain testing or other "designated health services" under the Stark Law can be a felony unless there is a properly documented method of sharing that qualifies under the Stark Laws. Failure to have this in writing in advance of a particular calendar quarter can constitute a felony offense.

5. <u>Failure to Procure and Maintain Proper Insurances. There are myriad insurances required to appropriately safeguard a medical practices from the normal risks of doing business, particularly in view of the American trial system.</u>

Fortunately most of these risks can be reasonably handled on an affordable basis, assuming that proper coverage is in place.

The most important coverage is clearly malpractice insurance, which is addressed below as a separate section, but other insurances which are essential to the well-being of physicians and their medical practices include:

1) disability insurance,
2) overhead insurance to handle practice expenses during a period of disability or in the event of a natural disaster such as a hurricane or acts of terrorism,
3) liability insurance to cover non-malpractice obligations, such as if patients or others hurt themselves in the parking lot or fall on slippery areas in the office,
4) workers' compensation insurance to protect the practice against state laws that can require lifetime support and/or significant monetary payments to be made to an employee injured in the course of employment, and
5) unowned automobile liability insurance to insure against the liability that occurs to a medical practice if any employee is in an automobile accident while running errands or otherwise working in the course of medical practice business.

Individual automobile liability policies should also be reviewed to ensure that each physician has coverage for medical practice-related driving. Many personal policies will not cover business driving without additional policy riders. The author commonly recommends at least $3,000,000 - $5,000,000 worth of umbrella liability coverage to cover all business and personal driving, and driving by others who might use the doctor's car.

There are thousands of disabled physicians in the United States now living on disability insurance. The author has more than 15 clients who have been able to "retire" on their disability insurance. This explains why the rates are so high to procure such coverage, but also why having good coverage is a necessity rather than a luxury for physicians who do not have adequate retirement savings to support themselves and their families for their remaining lifetimes.

Sometimes individual health insurance policies will not cover on-the-job injuries under the presumption that a doctor will be covered under workers' compensation for on-the-job injuries. Doctors who do not have workers' compensation insurance, which is often waived to save money, should check their health insurance policies to make sure that they are covered for on-the-job injuries.

6. Failure to Make the Medical Malpractice and Doctor Judgment-Proof. There are many ways that a medical practice and a doctor can work to make themselves a less attractive target for a plaintiff's lawyer.

Often the practice incurs debt in its name, and the lender or lenders have liens on practice and personal assets that must be paid before a plaintiff is able to levy upon a doctor or practice. Also, valuable assets like real estate and furniture and equipment can be owned by a separate entity that would lease those assets to the medical practice to make them inaccessible, or at least less accessible, to a malpractice claimant.

It is also important to ensure that each physician in a group has his or her personal creditor protection planning properly in place so that a plaintiff lawyer can be led to settle within policy limits if and when a catastrophic lawsuit occurs.

Because of state and bankruptcy law fraudulent transfer law statutes, it is often crucial that creditor protection planning for the medical practice entity and the doctors occur well before any problems arise.

When a serious lawsuit occurs, the doctors should keep in mind that the lawyer hired by the insurance company does not necessarily have duty of absolute loyalty to the doctor. The malpractice insurance carrier selects and pays the lawyer.

There are often circumstances whereby an independent lawyer should be hired by the doctor to encourage the insurance carrier to settle a claim within policy limits when the opportunity arises, in order not to risk the doctor's personal and practice assets to an "excess verdict." Many states have laws that will require an insurance carrier to be responsible for any excess verdict if proper demand has been made upon the carrier when it had the opportunity to settle within policy limits. These are called the "bad faith" rules.

7. <u>Failure to Theft-Proof the Practice's Monies and Accounts Receivable. The author regularly receives at least one phone call per year from a very upset physician who has had tens of thousands of practice dollars stolen by an employee. This employee has often been with the practice many years, and most of the time is the most trusted person in the practice other than the physicians themselves. As such, the employee is able to obtain physical possession of checks made payable to the practice by one or more payor sources and/or has written checks on the practice accounts for bogus expenses.</u>

Over the years, the author has seen medical practices unwillingly and unwittingly pay credit card expenses, electric company expenses, car payments, and even home mortgage payments for a medical practice employee. When the circumstances are reviewed, they reveal that most of these situations would have been avoidable with proper supervision and use of appropriate safeguards.

Additionally, money is often stolen from practice accounts when large projects such as buildings, construction, or similar matters are administered by a person who signs the checks and/or administers the checks and invoices for a busy physician.

Most of the time the theft is carried out by the most trusted office manager without any assistance from another employee.

It is a very basic accounting system principle that the person or people who physically open the envelopes containing checks payable to the practice record the checks onto a log and ensure that the checks are properly deposited. These deposits are then reported to a separate employee who has the ability to record the payments in the practice's computer system.

It is a fatal error to allow one individual to have physical possession of checks and also the ability enter payments or write-offs onto the practice's billing computer system. Even spouses have been known to steal from medical practices, especially when there are multiple partners.

Many practices use a post office box for checks to eliminate the risk of someone being able to "snatch a few checks from the mail" before they can be posted. Many banks offer check-depositing services and addresses that can be used as well. These are often known as "lock box" arrangements.

Larger practices can have someone from their CPA firm visit the practice on an annual basis without advance notice to the practice personnel. This demonstrates to employees that there is some degree of monitoring going on and can discourage practice theft.

8. Using Greedy Investment Advisors. The number of different investments and life insurance and annuity arrangements that can be sold to doctors and their practices in the financial world. The quality of each particular investment vehicle can vary dramatically in terms of actual financial safety, conservative versus aggressive orientation, likelihood of being acceptable to the IRS in the event of an audit, and as to the amount of commissions paid to advisors who may suggest such arrangements.

Expecting a physician to read a prospectus or to understand a complicated tax maneuver is like expecting a lawyer or a CPA to read an EKG- it is easy to be fooled!

If the advisors are earning a significant portion of the amounts invested as compensation, a degree of manipulation, non-disclosure, exaggeration or outright lying can take place.

In the pension world, actuaries and many CPA firms who practice extensively in the retirement plan arena can yield the great results for clients. Pension and profit-sharing plans are well-protected under applicable creditor laws and well-accepted under the tax law in conventional form.

More aggressive plans such as 419A Welfare Benefit plans and 412i plans should be examined carefully by independent advisors before investing.

The author urges clients to use independent accountants who are not compensated directly or indirectly for the sale of financial products. The author has seen entire fortunes lost to tax shelter deals in the 1970s, leveraged real estate deals in the 1980s, land development deals in the 1990s, and now Madoff and related Ponzi and margined-securities deals in the present decade. Crime often pays, and the victim is the doctor who gets involved in these types of arrangements.

There is rarely a good reason for a pension or profit-sharing plan to own a life insurance or annuity product, except to compensate anyone who may be licensed in life insurance and annuities who has involvement in the pension or profit-sharing

9. Unbalanced Investment Portfolio. Statistical studies show that a diversified portfolio of investments will generally out perform a non-diversified portfolio, with significantly less risk. Many successful clients own investment real estate, mutual funds allocated among the various classes of stock investments, and bond funds or CDs. It almost never makes sense for anyone to put all of their eggs in one basket.

Go For Singles and Doubles, Not Home runs. Time and time again we have seen physicians place significant portions of their financial assets into high risk investments or ventures with the intention of hitting “a home run” under risky circumstances.

There is almost always a direct and opposite correlation between expected rate of return and risk being taken. Many high income professionals recognize this and are nevertheless willing to take risks. Quite often, however, physician investors are assured that an arrangement is “virtually risk free” even though it is expected (or touted) to yield a significant return. If it is too good to be true. . .it probably is.

10. Doing Business with the Wrong People. Unfortunately, crime, and also deceitful or misleading behavior can be lucrative for the "bad or careless actor," and these individuals are often found courting doctors to do business and investment transactions or to provide consulting services.

Since the overwhelming majority of doctors are very honest and do not have formal business training, it is not difficult to market "unique propositions" to doctors and to eventually find a handful of doctors who may succumb to participate in a recommended arrangement.

Commonly these "bad actors" will present themselves through relatives, friends and possibly even misled advisors.

Typically the doctor will be asked to invest in a startup or growing company, to help start a new business, or to be involved in the purchasing or financing of real estate.

Bad actors are often well-dressed, exhibit success in the forms of nice house and cars, and sometimes even jet airplanes, stunning vacations, trophy wives, and impressive club memberships.

A team of advisors can usually sniff out this type of individual or organization by checking references, or the lack thereof, licensing, and with other professionals who have worked with the applicable individual. The author has seen this occur in billing companies, unique invention startups, real estate ventures, medical related companies, ice machines (that did not exist), Ponzi schemes, and other situations.

If it sounds too good to be true it usually is! And do not forget the adage about the experienced businessman and the doctor who become partners. The businessman puts in his experience and the doctor puts in his money. At the end of the day the businessman has the money and the doctor merely has an experience!

Doctors with gamble-holic tendencies are often drawn to elusive schemes where the doctor is told that he or she has earned millions of dollars and should have colleagues put money in so that they can earn millions too, while in reality the "con job" is that the money is being stolen or used to pay debts on assets that will never be worth anything. A junior Madoff may be your next door neighbor or brother-in-law!

Every year the IRS publishes the "Dirty Dozen," a list of tax frauds, including schemes involving the internet, domestic tax crimes, offshore frauds and false claims for refunds. This is done for the benefit of citizens and their awareness of financial predators. The IRS website at http://www.irs.gov/newsroom/article/0,id=206370,00.html says it right: "Taxpayers should be wary of scams to avoid paying taxes that seem too good to be true, especially during these challenging economic times," Commissioner Doug Shulman said. "There is no secret trick that can eliminate a person's tax obligations. People should be wary of anyone peddling any of these scams.“

Don’t be a jerk… or get involved with jerks

11. Failure to Have Anyone in the Practice Pay Attention to Contracts with Third Parties. Quite often medical practices get into disputes or find themselves stuck in agreements as a result of a trusting nature or lack of attention to details associated with contracts they enter into with third parties. Say, for example, somebody delivers a copier to the medical practice that the office manager has requested on a trial basis. Upon delivery, that person gets the receptionist to sign a contract accepting copier and binding the practice to 48 months of payments.

Another example is when a medical practice has a lease that gives the doctors the right to extend after a certain date, but they forget to give notice of extension by the deadline. The practice gets held up by the landlord for a larger rent payment or has to vacate and find new property.

A third example is when a lease for a large piece of equipment also requires the practice to maintain the equipment with one company only. The company may provide poor service or may not permit the practice to pre-pay the lease or re-finance it from a high rate of interest without paying tens of thousands of dollars in penalties.

Another trap some practices fall into is using an office manager or non-CPA accountant to draft legal documents that employ physicians or to set up companies for the practice, not realizing that the contracts have inappropriate provisions or do not cover essential items that a lawyer or appropriately qualified advisor would have pointed out.

F. Lee Baily said that "anyone who acts as his own lawyer has a fool for a client."

Most successful lawyers hire other lawyers to do work for them personally when it is outside of their area of specialty, or sometimes even when it is within their area of specialty because of this phenomenon.

If lawyers are smart enough not to do legal work for themselves, why aren't doctors and their other advisors?

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8 COMMON LLC PLANNING ERRORS

By: Alan S. Gassman, J.D., LL.M.

Some of the most common problems we encounter in reviewing LLC arrangements for clients are:

1. TENANCY BY THE ENTIRETIES" DESIGNATION THAT WILL NOT QUALIFY AS TENANCY BY THE ENTIRETIES.

Many married couples in states that protect tenancy by the entireties assets from the creditors of one spouse or the other have their LLC interests titled jointly as tenants by the entireties.

But they don't realize that there are provisions in the operative documents which are inconsistent and would thus annul tenancy by the entireties characterization and protection.

Common examples of this are:

(a) By the rules of tenancy by the entireties, the joint interest must pass outright solely by the surviving spouse in the event of the death of the surviving spouse. Oftentimes an operational document will provide that on the death of a member, the interest of that member must be sold. Agreements are commonly not drafted to explicitly provide that on the death of a spouse, the other spouse will be the owner of the joint interests, without any inconsistent member agreement provisions.

(b) Similarly, provisions under an operative document which restrict transfers may actually be read to prevent one spouse from owning the entire member interest on the death of another spouse.

(c) While the certificate of ownership may be issued to both spouses as tenants by the entireties, oftentimes the Operating Agreements or Articles of Organization will provide for only one spouse or the other to be an owner.

2. ENTITY DOCUMENTS CAN DISQUALIFY S ELECTION.

Limited liability companies may be treated as S Corporations under the federal income tax law if certain very strict requirements are met and an S election is made.

If the S election is made but the S Corporation requirements are not met, then the company will be taxed as a "C Corporation," therefore exposing properties and income to double tax.