[We redact certain identifying information and certain potentially privileged, confidential, or proprietary information associated with the individual or entity, unless otherwise approved by the requestor.]

[name and address redacted]

Re: Advisory Opinion No. CMS-AO-2020-02

Dear [name redacted]:

We write in response to the request by [name redacted] (the "Requestor" or the "Practice") for an advisory opinion regarding a proposal by the Requestor to establish and be the sole member of a nonprofit hospital (the "Hospital"). Specifically, you seek a determination whether referrals to the Hospital from the Practice's physician-shareholders (the "Physician Owners") would be prohibited under section 1877(a) of the Social Security Act (the "Act") because the Physician Owners would have an ownership or investment interest in the Hospital that does not satisfy the requirements of an applicable exception under section 1877 of the Act or the regulations at 42 C.F.R. § 411.350 et seq. (collectively, the "physician self-referral law").

You certified that the information provided in the request, including all supplementary materials and documentation, is true and correct and constitutes a complete description of the relevant facts. In issuing this opinion, we have relied solely on the facts and information presented to us. We have not undertaken an independent investigation of this information. If material facts were not disclosed or were misrepresented, this advisory opinion is without force and effect.

Based on the specific facts certified in the request for an advisory opinion and supplemental submissions, we conclude that the Physician Owners of the Practice will not have an ownership or investment interest in the Hospital for purposes of the physician self-referral law. We express no opinion regarding any other provision of section 1877 of the Act or the regulations at 42 C.F.R. Part 411, Subpart J.

I. FACTUAL BACKGROUND

The Requestor is a multidisciplinary physician practice, organized as a medical service corporation under [state redacted] ("State") law. Physician Owners have an aggregate 60 percent ownership interest in the Practice, and the remaining 40 percent ownership interest is held by non-physicians that are not immediate family members of Physician Owners.

The Practice's main campus is located in [city redacted] ("City"). City is located in a Micropolitan Statistical Area that is designated by the Health Resources and Service Administration of the U.S. Department of Health and Human Services as a medically

underserved area and also qualifies as a health professional shortage area for primary care, mental health, and dental care. The Practice has additional practice sites in State and in neighboring states, and, according to the Requestor, it is a significant source of primary, specialty, and subspecialty rural health care in the region. There is currently only one hospital in City, a full-service acute care hospital. There is no other full-service acute care hospital within a 100-mile radius of City.

Requestor is proposing to develop and be the sole member of the Hospital, which will be located in City. As a nonprofit corporation operating under State's laws governing nonprofit corporations, the Hospital will not issue any "shares" or "stocks" and the Hospital will not be permitted to make any ownership or profit distributions to the Requestor. The Requestor certified that any profits derived from the operation of the Hospital will be redirected towards the development of Hospital facilities, including the purchase of new equipment, development of new service lines, or other *bona fide* operational purposes of the Hospital. In the event that the Hospital or its assets are sold, State law limits the distribution of a nonprofit corporation's assets to an exchange for goods and services, repayment of membership contributions in an amount that may not exceed the original contribution, or in furtherance of the nonprofit corporation's charitable purpose. State law also restricts how a nonprofit corporation may distribute any remaining assets in case of bankruptcy. Given the limits of State's laws governing nonprofit corporations, the Requestor certified that neither the Practice nor the Physician Owners will have the ability or right to receive the financial benefits of ownership or investment in the Hospital.

Although the Hospital will be organized and operate as a nonprofit corporation under State law, the Requestor is not planning to seek tax-exempt status for the Hospital under section 501(c)(3) of the Internal Revenue Code. Typically, hospitals that qualify as tax-exempt under section 501(c)(3) of the Internal Revenue Code are governed by a community board, with a majority of independent members drawn from the community.[1] Because the Requestor seeks to have physicians maintain operational control of the Hospital, it is proposing a board of directors with a majority of members drawn from the Practice's Physician Owners. A minority of board members will be business leaders from the community.

The Requestor anticipates that the Practice will enter into various compensation arrangements with the Hospital for the provision of professional services, medical directorships, or other personal service arrangements. The Requestor states that the compensation arrangements will be structured individually and in the aggregate to satisfy all the requirements of an applicable exception to the physician self-referral law and, further, that such compensation arrangements will be subject to State nonprofit law governing compensation to members, officers, and directors for services furnished to the nonprofit entity. In addition to the board of directors, the Hospital will establish an independent physician transaction review board to ensure that any financial relationships

[1] See IRS Publication, *Charitable Hospitals – General Requirements for Tax-Exemption Under Section 501(c)(3)*, available at https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3.

between the Hospital and the Requestor or its Physician Owners (or their family members) satisfy the requirements of an applicable exception to the physician self-referral law and do not inure to the private benefit of the Physician Owners (or their immediate family members) in a manner that would undermine the Hospital's nonprofit purpose.

Finally, the Requestor certified that the Hospital will have an open medical staff, and physicians will not have to be shareholders, employees, or independent contractors of the Practice in order to obtain privileges and practice medicine at the Hospital.[2]

II. LEGAL ANALYSIS

a. Law and Regulations

The physician self-referral law establishes two prohibitions: (1) it prohibits a physician from making referrals for certain designated health services payable by Medicare to an entity with which he or she (or an immediate family member) has a financial relationship, unless all requirements of an applicable exception are satisfied; and (2) it prohibits the entity from filing claims with Medicare (or billing another individual, entity, or third party payer) for any improperly referred designated health services.

Financial relationships under section 1877(a)(2) of the Act include ownership or investment interests and compensation arrangements. Section 1877(a)(2) of the Act further stipulates that an ownership or investment interest may be through equity, debt, or other means and includes an interest in an entity that holds an ownership or investment interest in any entity providing the designated health service. The regulations at 42 C.F.R. § 411.354(b)(1) and (5) provide that stock and limited liability company memberships constitute ownership or investment interests, and an indirect ownership or investment interest exists if, between the referring physician and the entity furnishing designated health services, there is an unbroken chain of any number of persons or entities having ownership or investment interests.[3]

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[2] According to IRS guidance on 501(c)(3) hospitals, "[a] hospital that restricts its medical staff privileges to a limited group of physicians is likely to be operating for the private benefit of the staff physicians rather than for the public interest. By the same token, the hospital does not need to grant medical staff privileges to every physician that requests them to be considered operating for the benefit of the community." IRS Publication, *Charitable Hospitals – General Requirements for Tax-Exemption Under Section 501(c)(3),* available at https://www.irs.gov/charities-non-profits/charitable-hospitals-general-requirements-for-tax-exemption-under-section-501c3.

[3] The regulations pertaining to indirect ownership or investment interests at 42 C.F.R. § 411.354(b)(5) also provide that, for a chain of ownership or investment interests to qualify under the physician self-referral law as an indirect ownership or investment interest, the entity furnishing designated health services must have actual knowledge of, or act in reckless disregard of deliberate ignorance of, the fact that the referring physician has some ownership or investment interest in the entity. It is undisputed in this instance that the Hospital would have such knowledge.

In a 1998 notice of proposed rulemaking (the "1998 Proposed Rule"), we proposed that membership in a nonprofit corporation generally would not constitute an ownership or investment interest in the corporation for purposes of the physician self-referral law.[4] In the 1998 Proposed Rule, we explained that most nonprofit corporations are exempt from taxation under sections 501(c)(3) or (4) of the Internal Revenue Code, which provide that the net earnings of a nonprofit corporation cannot inure to the benefit of any private shareholder or individual. With respect to nonprofit corporations that are exempt from taxation under sections 501(c)(3) or (4) of the Internal Revenue Code, we stated that:

> [W]hile members of such a nonprofit corporation may exercise control over the activities of the corporation, they do not have the pecuniary incentive that for-profit investors have to enhance their investment interests. As such, we do not regard being a member of these kinds of nonprofit corporations as an ownership or investment interest analogous to being a shareholder in a for-profit corporation.[5]

We cautioned in the 1998 Proposed Rule that any remuneration that a physician or family member receives from the nonprofit corporation, such as salary, is compensation that must satisfy the requirements of an applicable exception.[6] In our 2001 interim final rule with comment period ("Phase I"), we stated that we generally adopted the overall interpretations of "financial relationship" in the 1998 Proposed Rule, with the exception of "indirect" financial relationships.[7] Thus, our statements in the 1998 Proposed Rule regarding membership in a 501(c)(3) or (4) nonprofit corporation are a longstanding interpretation.

Applying this interpretation in a 2005 advisory opinion,[8] we concluded that physicians who owned one share of capital stock in a nonprofit multidisciplinary practice did not have an ownership or investment interest in the practice,[9] because the physician-shareholders were essentially similar to members in a nonprofit corporation. In reaching this conclusion, we noted that the value of the capital stock remained constant and was not affected by the financial performance of the practice; qualifying physicians paid $1,000 for one share of stock and, upon leaving the practice, returned the share and received $1,000 in return, with no interest. In addition, physician-shareholders received no dividends on the stock, either overtly or covertly in the form of salaries or other compensation paid to physician-shareholders, and the practice's assets could not be distributed to individual physician-shareholders.

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[4] 63 Fed. Reg. 1659, 1707 (Jan. 9, 1998).
[5] 63 Fed. Reg. 1707.
[6] *Id*.
[7] 66 Fed. Reg. 856, 864 (Jan. 4, 2001).
[8] CMS-AO-2005-01 (available at https://www.cms.gov/Medicare/Fraud-and-Abuse/PhysicianSelfReferral/Downloads/CMS-AO-2005-08-01.pdf).
[9] At the time the practice was incorporated, relevant state law provided for the issuance of capital stock, regardless of whether the corporation was for-profit or not-for-profit.

In the Fiscal Year 2009 Hospital Inpatient Prospective Payment System final ("FY 2009 IPPS Final Rule"), we introduced the concept of titular ownership or investment interests in the context of our rulemaking pertaining to compensation arrangements and physicians who "stand in the shoes" of their physician organizations under 42 C.F.R. 411.354(c).[10] We stated that, for purposes of determining whether a compensation arrangement between an entity and a physician organization is deemed to be a compensation arrangement between the entity and a physician owner of the organization, a physician whose ownership interest in the physician organization is merely titular in nature is not required to stand in the shoes of the organization.[11] We explained that an ownership or investment interest is "titular" if the ownership or investment interest excludes the ability or right to receive the financial benefits of ownership or investment, including, but not limited to, the distribution of profits, dividends, proceeds of sale, or similar returns on investment. Although the concept of titular ownership developed in the FY 2009 IPPS Final Rule applies to the determination of whether a compensation arrangement exists between a physician and an entity, similar principles apply to the determination of whether a physician has an ownership or investment interest in an entity.

b. Analysis

The question presented by the Requestor is whether the Physician Owners of the Practice would be considered to have an ownership or investment interest in the Hospital for purposes of the physician self-referral law, because the Physician Owners own the Practice and the Practice would be the sole member of the Hospital. As illustrated by our rulemakings pertaining to nonprofit membership and titular ownership and our 2005 advisory opinion, the focus of the analysis is whether the Physician Owners will be able or entitled to receive the *financial* benefits of ownership of the Hospital.

The Hospital will be organized as a nonprofit entity under State law, with the Practice as its sole member. Consistent with our longstanding interpretation of the term "financial relationship," membership in a nonprofit corporation generally does not constitute an ownership or investment interest for purposes of the physician self-referral law.[12] Although this interpretation focused on nonprofit health corporations that are tax-exempt under section 501(c)(3) or (4) of the Internal Revenue Code, State's nonprofit corporation law contains analogous restrictions on the distribution of profits and corporation assets. As a nonprofit corporation under State law, the Hospital will not be permitted to pay dividends or distribute money, property, or other corporation assets to the Practice or the Physician Owners. Likewise, the Hospital is not permitted to repay the Practice for membership contributions in excess of the original contribution amount. The Requestor certified that any profits earned by the Hospital will be redirected towards the development of Hospital facilities, including the purchase of new equipment, development of new service lines, or other *bona fide* operational purposes of the Hospital. Given these facts, we conclude that the Practice will not be entitled to receive

[10] 73 Fed. Reg. 48434, 48693–48699 (Aug. 19, 2008).
[11] 73 Fed. Reg. 48693.
[12] *See* 63 Fed. Reg. 1659, 1707 (Jan. 9, 1998); 66 Fed. Reg. 856, 864 (Jan. 4, 2001).
[12] 63 Fed. Reg. 1707; 66 Fed. Reg. 864.

the financial benefits associated with ownership, including the distribution of profits, dividends, proceeds of sale, or similar returns on investment. Therefore, the Practice does not have a direct ownership or investment interest in the Hospital.

Insofar as the Practice does not have a direct ownership or investment interest in the Hospital, the Physician Owners' ownership or investment interest in the Practice does not give rise to an indirect ownership or investment interest in the Hospital. Specifically, the Physician Owners (and their immediate family members) will not be able or entitled to receive the financial benefits of ownership of the Hospital either overtly, in the form of profit distributions, dividends, proceeds of sale, or similar returns on investment, or covertly, in the form of salaries or other compensation paid to the Practice, its Physician Owners, or the Physician Owners' immediate family members. The Requestor certified that all compensation arrangements between the Hospital and the Practice, its Physician Owners, and the Physician Owners' immediate family members will be structured individually and in the aggregate to satisfy all the requirements of an applicable exception to the physician self-referral law, including, where applicable, requirements that the arrangement is commercially reasonable and that compensation is fair market value and not determined in any manner that takes into account the volume or value or referrals or other business generated between the parties. Further, State's nonprofit law includes prohibitions on private benefit and inurement similar to those found in Federal nonprofit law governing tax-exempt Hospitals under section 501(c)(3) or (4) of the Internal Revenue Code. The Hospital will also have an open medical staff to ensure that the Hospital is not operating for the private benefit of the Physician Owners rather than for the public interest.

In sum, we believe that the safeguards provided under State nonprofit law and the physician self-referral law as applied to compensation arrangements ensure that neither the Practice nor its Physician Owners (or their immediate family members) will receive the financial benefits of ownership of the Hospital. Therefore, we conclude that the Physician Owners will not have an ownership or investment interest in the Hospital for purposes of the physician self-referral law.

III. CONCLUSION

Based on the facts certified in your request for an advisory opinion and supplemental submissions, we conclude that the Practice will not have an ownership or investment interest in the Hospital by virtue of the Practice's status as the sole member of the Hospital; therefore the Physician Owners will not have an ownership or investment interest in the Hospital for purposes of the physician self-referral law. We express no opinion regarding any other provision of section 1877 of the Act or the regulations at 42 C.F.R. Part 411, Subpart J.

IV. LIMITATIONS

The limitations applicable to this opinion include the following:

- This advisory opinion is issued to the Requestor of this opinion. The U.S. Department of Health and Human Services will not impose sanctions under section 1877(g) of the Social Security Act with respect to the Requestor and all individuals and entities that are parties to the arrangement described therein. Individuals and entities other than the parties to the arrangement may rely on this advisory opinion as an illustration of the application of the physician self-referral law and regulations to the specific facts and circumstances described in the advisory opinion in accordance with 42 C.F.R. § 411.387(c).

- This advisory opinion may not be introduced into evidence in any matter involving an entity or individual that is not a Requestor of this opinion, except as permitted under 42 C.F.R. § 411.387(a)(2) and (b).

- This advisory opinion is applicable only to the statutory and regulatory provisions specifically noted above. No opinion is expressed or implied herein with respect to the application of any other Federal, state or local statute, rule, regulation, ordinance, or other law that may be applicable to the Requestor, including, without limitation, the Federal anti-kickback statute, section 1128B(b) of the Act (42 U.S.C. §1320a-7b(b)) and Federal or State law governing not-for-profit corporations or entities.

- This advisory opinion will not bind or obligate any agency other than the U.S. Department of Health and Human Services.

- CMS reserves the right to reconsider the questions involved in this advisory opinion and, for good cause (as defined at 42 C.F.R. § 411.382 (a)(2)), may rescind or revoke this opinion.

- This advisory opinion is limited in scope to the specific arrangement described in this letter.

- No opinion is expressed herein regarding the liability of any party under the False Claims Act or other legal authorities for any improper billing, claims submission, cost reporting, or related conduct.

This opinion is also subject to any additional limitations set forth at 42 C.F.R. §§411.370 through 411.389.

Sincerely,

Elizabeth Richter
Deputy Director
Center for Medicare