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Health Care Law

Professional Corporations Remain the Most Popular Form of Entity for Medical Practices

U.S. Supreme Court negates one disadvantage of professional corporations while creating uncertainties in other areas

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While addressing what is considered to be an inconsistency in the law regarding the definition of an employee in *Clackamas Gastroenterology Assocs. v. Wells*, 123 S. Ct. 1673 (April 2, 2003), the U.S. Supreme Court created a new consideration when looking at the advantages and disadvantages of choosing a corporation as a business entity for a physician practice.

Gone are the days when a doctor simply hung out a shingle and provided health care services without first seeking business counsel. Today various risks and benefits — ranging from tax incentives to regulations regarding fraud and abuse — require that physicians choose an appropriate legal entity for their practice.

Originally, the choice of a business entity was limited to the sole proprietorship and the general partnership. Such entities had inherent disadvantages with respect to personal liability and vicarious liability for partners' acts, as well as certain tax advantages. With recognition of these disadvantages, business planners began to recommend the use of professional corporations. But even though professional corporations are advantageous for liability purposes, they no longer have the tax advantages they once enjoyed.

Recently, an amalgamation of the corporation and the partnership has emerged in the form of limited liability entities.

Professional corporations remain the most popular form of entity for existing medical practices and still offer some advantages. In *Clackamas*, the Supreme Court negated one disadvantage, but its decision may have created uncertainties in other areas.

Clackamas

The *Clackamas* lawsuit was initiated by Deborah-Anne Wells, a bookkeeper for Clackamas Gastroenterology Associates, P.C. ("CGA"), after she was fired following 11 years of service. Wells, who suffered from a mixed connective tissue disorder, alleged that CGA did not comply with her requests for reasonable accommodations in her job responsibilities that were necessary due to her illness, and ultimately fired her.

In addition to state and common law causes of action, Wells filed suit alleging unlawful discrimination on the basis of her disability under Title I of the Americans with Disabilities Act.

CGA moved for summary judgment, claiming that it was not liable for ADA compliance under a regulatory exemption for businesses with less than 15 employees for 20 weeks. See 42 U.S.C. §12101, et seq. The issue that the U.S. District Court, the Ninth U.S. Circuit Court of Appeals and, ultimately, the U.S. Supreme Court, addressed was whether the four physician-shareholders of CGA were employees for the purposes of the ADA exemption.

The Court first looked at the ADA's definition of an employee. The Court described the ADA's definition of employee as "nominal" and "circular." The Court relied on the common law definition of a master-servant relationship for guidance. This definition hinges on whether the servant or employee is controlled by the master or employer. In this case, since CGA did not control the physicians, but rather,

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the physicians controlled CGA, as directors, the Court held that the physicians may not be employees.

It should be noted that while the Court used the *Clackamas* case to provide guidance on how to define an employee, the decision as to whether the Clackamas physician-shareholders were ultimately employees was seen as an issue of fact that exceeded the scope of review of the Court.

The Equal Employment Opportunity Commission is the administrative department responsible for enforcement of the ADA. Accordingly, the Court considered the EEOC's definition of an employee.

In administrative reference documents, the EEOC has suggested "if the shareholder-directors operate independently and manage the business, they are proprietors and not employees; if they are subject to the firm's control, they are employees."

In determining whether the physician-shareholders operate independently, the Court adopted six factors from the EEOC Compliance Manual. The six factors are:

- whether the organization can hire or fire the individual or set the rules and regulations of the individual's work;
- whether and, if so, to what extent, the organization supervises the individual's work;
- whether the individual reports to someone higher in the organization;
- whether and, if so, to what extent, the individual is able to influence the organization;
- whether the parties intended that the individual be an employee, as expressed in written agreements or contracts; and
- whether the individual shares in the profits, losses and liabilities of the organization. 123 S. Ct. 1680.

In determining the definition of an employee, labels, as created by documents such as employment agreements, no longer stand alone. The Court advised that the above six-factor test must be used for such a determination. In doing so, all six factors should be given equal consideration, and "no one factor (should) be decisive."

Based on the records leading to the Court's review of *Clackamas*, the Court suggested that under this inquiry, the physician-shareholders are not likely to be employees. However, because a proper inquiry would require fact finding, the Court remanded the issue to the Ninth Circuit.

The six-factor test adopted in *Clackamas* allows physician-shareholders to be excluded from the employee count for the purposes of ADA exemption.

Six-Factor Test

On its face, the *Clackamas* holding eliminates one disincentive for choosing a professional corporation as the form of entity for a professional practice.

The six-factor test adopted by the Court allows physicians, when they are shareholders of the professional corporation, to be excluded from the employee count for the purposes of ADA exemption.

What is unknown, however, is the extent to which this holding will affect statutes and regulations other than the ADA.

As of Oct. 16, 2003, the Administrative Simplification Compliance Act requires that all Medicare claims be submitted electronically. 42 U.S.C. 1305. The ASCA does allow small providers an exemption from this requirement. A small provider is defined as a "physician, practitioner, facility or supplier (other than a provider of services) with fewer than 10 employees."

If a small provider elects to submit paper claims and does not transmit any protected health information electronically, the provider would not be considered a covered entity under Health Insurance Portability and Accountability Act. It is unclear as to whether the *Clackamas* holding applies to the ASCA.

Certain limitations already have been set on the *Clackamas* holding. Less than three months after *Clackamas*, the U.S. Tax Court distinguished *Clackamas* in *Western Management v. Commissioner of IRS*, T.C. Memo 2003-162 (June 3, 2003), suggesting that the *Clackamas* test for the definition of an employee should not be applied to tax issues.

In *Western Management*, a corporation tried to argue that its sole shareholder/officer was not an employee under the *Clackamas* test and, hence, the corporation should not be required to pay federal employment taxes for monies received by the sole shareholder/officer. The U.S. Tax Court did not accept this argument for defining an employee.

The *Clackmas* holding, implying that one must look past an entity's label to the substance of the entity, may have serious negative implications that were not fully realized by the Court.

For example, *Clackamas* provides an incentive to a potential plaintiff to pursue a claim that would otherwise be barred by corporate immunity by attempting to pierce the corporate veil. One significant area where the corporate veil may be pierced is that of minority shareholder rights.

The Corporate Veil

Traditionally, shareholders have been unable to bring federal discrimination claims, like those under the ADA or Title VII, against their fellow shareholders. In New Jersey, in corporations with 25 or fewer shareholders, minority shareholders are protected by statute from fraud, illegality, mismanagement, oppression or unfairness by those in

control. N.J.S.A. 14A:12-7(2).

However, the New Jersey minority shareholder rights statute does not provide for a minority shareholder to assert a federal discrimination claim against another shareholder. Under the *Clackamas* six-factor test, a minority shareholder may argue that he is really an employee. Once recognized as an employee, the minority shareholder may have the same rights with respect to federal and state discrimination claims that any other employee would be afforded.

Piercing the corporate veil under *Clackamas* is not just limited to minority shareholder claims. Other plaintiffs may find it beneficial to argue that the business acts more like a partnership than a corporation.

In instances where physician-shareholders within a practice act more like employees than employers, or where a professional corporation has been negligent in maintaining corporate records and filings, liability may be created among all physicians within a practice. This is similar to the liability of a partnership, despite the intended protection of the corporate form of entity.

Finally, the *Clackamas* Court negated the original intent of the ADA small business size-exemption. The dissent points out that the majority did not consider an important fact: while the physicians may sometimes be the masters in the master-servant relationship in a professional corporation, they wear multiple hats. When providing services, the physicians are servants under the common law definition; when they are acting as directors, they are the masters in the relationship.

Thus, unlike a traditional business corporation, in the professional corporation, those rendering business services are also its owners. The dissent argues that the requirement to comply with the ADA and other regulations should not vary based on what hat a professional may wear at different times, but on the overall size of the entity and the entity's economic ability to comply with the ADA. It is foreseeable that corporations that could afford to adhere to the ADA may choose not to do so.

Ultimately, *Clackamas* creates uncertainty in that each entity must be assessed individually, based on the six-factor test, to determine whether the members of the corporation are employees.

While an individual analysis may create a benefit for some when it is determined that a worker within a corporation is not an employee, it may provide unintended risk for others in different areas. ■