



## **Track 3 – Session 4**

# **Wisconsin's Corporate Practice of Medicine Doctrine: Dead Letter, Trap for the Unwary, or Both?**

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**I. What is the "Practice of Medicine"?**

Like many states, Wisconsin defines the "practice of medicine" very broadly:

"Practice of medicine and surgery" means:

- (a) To examine into the fact, condition or cause of human health or disease, or to treat, operate, prescribe or advise for the same, by any means or instrumentality.
- (b) To apply principles or techniques of medical sciences in the diagnosis or prevention of any of the conditions described in par. (a) and in sub. (2) [defining the term "disease"].
- (c) To penetrate, pierce or sever the tissues of a human being.
- (d) To offer, undertake, attempt or do or hold oneself out in any manner as able to do any of the acts described in this subsection.

*See Wis. Stat. § 448.01(9).*

Wisconsin's Attorney General, in considering the predecessor statutory language—i.e., "treat the sick"—observed that "[t]his definition is about as far reaching as any that can be found." *See* 39 Op. Atty. Gen. Wis. 10 (June 6, 1950). In this opinion, the Attorney General considered the question of whether the operation of a laboratory, which conducted certain medical tests (including blood and other tests), constituted "treating the sick." The Attorney General concluded that it did not, noting:

Under the statement of facts as so given it does not appear that the technician in question either diagnoses or treats bodily ailments. All she does is to perform certain laboratory tests and to transmit the factual data thus obtained to a licensed physician who draws his own conclusions from the data presented.

The predecessor definition, contained at § 147.01(a) Wis. Stat., was nearly identical to subsections (a), (b) and (d) of current section Wis. Stat. 448.01(9). Importantly, however, it did not contain any provision corresponding to subsection (c) – regarding the piercing or severing of tissues. Thus, this opinion only confirms that inserting needles did not, in and of itself, constitute the practice of medicine back in the 50’s. However, it appears that the Wisconsin Legislature effectively reversed this ruling by adding subsection (c) and adopting a regulatory framework for laboratories. *See* Wis. Stat. § 299.11.

In any event, the definition of “practice of medicine and surgery” literally covers a broad swathe of human activity. Accordingly, one must unavoidably rely on the regulatory bodies to apply common sense in determining what constitutes the “practice of medicine” in Wisconsin under these rules. Unfortunately, we cannot rely on analogies to other health care related activities that are clearly understood to be outside the scope of the “practice of medicine,” because many of these activities have been specifically excluded from the “practice of medicine” regulatory regime, but are subject to their own rules of practice and credentialing. *See, e.g.*, Wis. Stat. § 448.50 et seq., (physical therapists); § 448.60 et seq. (podiatrists); § 448.70 et seq. (dietitians); § 448.95 et seq. (athletic trainers); § 448.96 et seq. (occupational therapists).

When one also considers that the Wisconsin legislature has even enacted special provisions regarding many other activities that might fall under the ambit of § 448.01(9)(c) – e.g., tattooing (Wis. Stat. § 252.23), body piercing (Wis. Stat. § 252.24), acupuncture (Wis. Stat. Chapter 451) and barbering or cosmetology (Wis. Stat. Chapter 454) – the enormity of the potential scope of the “practice of medicine” starts to come into view.

## **II. Wisconsin’s Corporate Practice of Medicine Doctrine**

A. Background. For-profit corporations have traditionally been prohibited from practicing medicine for fear that corporate control could interfere with the personal relationship between physician and patient. *See* 75 Op. Att’y Gen. 200, 201 (OAG 39-86) (*citing* 61 Am Jur. 2d Physicians and Surgeons §154 (1981)). Such “corporate practice of medicine” was held to be against public policy because it placed “undue emphasis on mere money making, and commercial exploitation of professional services.” *See id.* (*quoting* *Bartron v. Codington County*, 68 S.D. 309, 2 N.W.2d 337, 346 (1942)). While the general historic prohibition against the corporate practice of medicine was intended to protect the public, it also had the effect of preventing physicians from taking advantage of the tax and other benefits of the corporate form. To allow professionals to obtain these benefits, while at the same time preventing the perceived problems which gave rise to the historic prohibition against corporate practice by professionals, the states began enacting professional service corporation statutes. *See id.* at 202.

However, navigating the application of the doctrine in today’s healthcare environment—with its myriad systems of clinical and financial integration between providers and hospitals—can be a surprisingly knotty proposition, on account of the dearth of any recent guidance. There are no published cases in Wisconsin, and almost all of the non-statutory guidance has come in the form of Attorney General Opinions—the most recent of which is almost thirty (30) years old now. Moreover, agency enforcement does not appear to have been all that rigorous.

B. Sources. Wisconsin’s prohibition on the “corporate practice of medicine” derives primarily from the interaction of three distinct provisions of Chapter 448 of the Wisconsin Statutes.

1. The first source is Wis. Stat. § 448.03(1)(a), which provides, in pertinent part, that “[n]o person may practice medicine and surgery, or attempt to do so or make a representation as authorized to do so, without a license to practice medicine and surgery granted by the board.”

(a) Per Wis. Stat. § 990.01(26), when the word “person” appears in the Wisconsin statutes, it is to be construed as including all partnerships, associations and bodies politic or corporate. Therefore, section 448.03(1) prohibits corporations and other entities from practicing medicine as a general matter.

(b) Only an individual may qualify for a license to practice under section 448.05, Wis. Stat., because a corporation or other entity cannot graduate from medical school or complete the requisite post-graduate training. *See* 75 Op. Att’y Gen. 200, 205 (OAG 39-86).

(c) Because a corporation cannot be licensed to practice medicine, Wis. Stat. §§ 448.03(1) and 448.01(9) prohibit it from engaging in any activities which constitute the practice of medicine. Moreover, Wis. Stat. § 448.01(9)(d) would prohibit a corporation from *offering, attempting or holding itself out* as able to perform any of the medical acts specified in Wis. Stat. § 448.01(9)(a) to (c). *See* 75 Op. Att’y Gen. 200, 205 (OAG 39-86).

(d) If a business corporation supplied medical services through licensed physicians, it would be offering to provide and providing services which constitute the practice of medicine. Therefore, section 448.03(1) prohibits a business corporation from providing medical services through employed professionals. *See id.*

2. The second source is Wis. Stat. § 448.08(1m), entitled “Fee-splitting”, which provides that:

Except as otherwise provided in this section, no person licensed or certified under this subchapter may give or receive, directly or indirectly, to or from any person, firm or corporation any fee, commission, rebate or other form of compensation or anything of value for sending, referring or otherwise inducing a person to communicate with a licensee in a professional capacity, or for any professional services not actually rendered personally or at his or her direction.

(a) The object of this law was to prevent physicians and surgeons in the larger cities from paying fees or commissions to the country physicians and surgeons for inducing or advising their patients to submit to operations and treatments by such city physicians and surgeons. Such fees or commissions were not for any services rendered to the patient, but purely a service rendered to the other physicians or surgeons in the way of sending them this business. *See* 71 Op. Att’y Gen. 108, 109 (OAG 31-82).

(b) This provision prohibits, among other things, a medical professional from giving any compensation to a business corporation in exchange for the corporation referring patients to the professional. If a corporation receives fees for services provided by a professional employee, this compensation could be construed as payment made by the professional to the corporation in exchange for the corporation's referring patients to the professional. *See* 75 Op. Att’y Gen. 200, 203 (OAG 39-86).

(c) If a business corporation receives compensation for a physician’s professional services and the physician receives patients through his or her employment with the corporation, then *the physician* is indirectly compensating the corporation for referrals which is deemed to be illegal fee splitting in violation of Wis. Stat. § 448.08(1m). *See id.* at 203-4.

(d) It is important to note that OAG 39-86 expressly provides that, for purposes of its discussion, unless otherwise indicated the term “*corporation*” meant a “*for-profit business corporation*” and not “*service corporations*” (which will be discussed in further detail below).

(e) Moreover, OAG 39-86 does not suggest that physicians working in the partnership form would run afoul of Wis. Stat. § 448.08(1m)—though, this is likely because partners in a partnership are—for both tax and agency purposes—are considered to be principles rather than employees.

3. The third source is Wis. Stat. § 448.08(2), entitled “Separate Billing Required”, which provides that:

Any person licensed under this subchapter who renders any medical or surgical service or assistance whatever, or gives any medical, surgical or any similar advice or assistance whatever to any patient, physician or corporation, or to any other institution or organization of any kind, including a hospital, for which a charge is made to such patient receiving such service, advice or assistance, shall, except as authorized by Title 18 or Title 19 of the federal social security act, render an individual statement or account of the charges therefor directly to such patient, distinct and separate from any statement or account by any physician or other person, who has rendered or who may render any medical, surgical or any similar service whatever, or who has given or may give any medical, surgical or similar advice or assistance to such patient, physician, corporation, or to any other institution or organization of any kind, including a hospital.

While this provision does not, of itself, prohibit a corporation from receiving compensation for medical services – rather it is a limitation on the providers themselves requiring that they must submit a separate statement of charges for services provided. *See* 75 Op. Att’y Gen. 200, 204 (OAG 39-86). However, in the absence of any exceptions, this limitation would create a significant obstacle to the affiliation of physicians in any sort of association form (incorporated or unincorporated).

4. A violation of any of the foregoing could give rise to significant sanctions, including fines of up to \$25,000 and even criminal sanction of up to 9 months imprisonment. *See* Wis. Stat. § 448.09(1m).

C. Exceptions for Professional Partnerships and Service Corporations.

1. Here in Wisconsin, we have what are (rather unfortunately) named “service corporations” – or “S.C.s” The difficulty with Wisconsin’s particular (and peculiar) naming convention is that, in their effort to distinguish “professional” entities from “non-professional entities,” the legislature has inadvertently created a source of potential confusion when it comes to discussing the nature of the corporation for tax purposes – *viz.* a Subchapter C Corporation (often called a “service corporation” when the principal business activity is the provision of professional services), or a Subchapter S Corporation (often referred to as an “S-Corp” – which is often wrongly assumed to be synonymous with an “S.C.”

2. Service corporations are a construct of Subchapter XIX of Chapter 180 of the Wisconsin Statutes, and are *specifically permitted* to “own, operate, and maintain an establishment and otherwise serve the convenience of its shareholders in

carrying on the particular profession, calling, or trade for which the licensure, certification, or registration of its organizers is required.” See Wis. Stat. § 180.1903(1).

3. A unique feature of the service corporation is that, like general partnerships—and unlike general business corporations—the service corporation for does *not* limit the personal liability of a shareholder, director, officer or employee for “his or her own omissions, negligence, wrongful acts, misconduct and malpractice and for the omissions, negligence, wrongful acts, misconduct and malpractice of any person acting under his or her actual supervision and control in the specific activity in which the omissions, negligence, wrongful acts, misconduct and malpractice occurred.” See Wis. Stat. § 180.1915(2).

4. Additionally, Wis. Stat. § 448.08(5) creates a specific exception to the requirement of separate billing for both service corporations and professional partnerships, stating:

Notwithstanding any other provision in this section, it is lawful for 2 or more physicians, who have entered into a *bona fide partnership* for the practice of medicine, to render a single bill for such services in the name of such partnership, and it also is lawful for a *service corporation* to render a single bill for services in the name of the corporation, provided that each individual licensed, registered or certified under this chapter or ch. 446, 449, 450, 455, 457 or 459 that renders billed services is individually identified as having rendered such services.

D. Exception for Hospitals and Medical Research Organizations.

1. Section 448.08(5), Wis. Stat., creates another specific exception to the general prohibition on fee-splitting through physician employment, which provides:

Notwithstanding any other provision in this section, when a hospital and its medical staff or a medical education and research organization and its medical staff consider that it is in the public interest, *a physician may contract with the hospital or organization as an employee or to provide consultation services* for attending physicians as provided in this subsection.

(Emphasis added.)

2. A “hospital” is defined by section § 448.08(1)(a), to mean “an institution providing 24-hour continuous service to patients confined therein which is primarily engaged in providing facilities for diagnostic and therapeutic services for the surgical and medical diagnosis, treatment and care, of injured or sick persons, by or

under the supervision of a professional staff of physicians and surgeons, and which is not primarily a place of rest for the aged, drug addicts or alcoholics, or a nursing home." Such hospitals may charge patients directly for the services of their employee nurses, non-physician anesthetists, physical therapists and medical assistants other than physicians or dentists, and may engage on a salary basis interns and residents who are participating in an accredited training program under the supervision of the medical staff, and persons with a resident educational license issued under Wis. Stat. § 448.04 (1) (bm) or a temporary educational certificate issued under Wis. Stat. § 448.04 (1) (c).

3. A "medical education and research organization" is defined by 448.08(1)(b) to mean "a medical education and medical research organization operating on a nonprofit basis." This rather tautological definition was expanded upon by OAG 31-86 (Sept. 8, 1986), an unpublished Wisconsin Attorney General Opinion, which stated:

It is my opinion that an organization qualifies as a medical education and research organization if its *dominant purpose and primary function* is to provide medical education and conduct medical research, if it is operating on a nonprofit basis *and* if any other aim or function of the organization is *incidental* to the dominant purpose and primary function. An organization could not qualify merely by asserting that 'medical education and research goes on here,' since that probably inheres in all professional practice.

(Emphasis added.)

4. In order to come within this exception for contracts between physicians and hospitals or medical education and research organization, the contract in question must:

- (a) Require the physician to be a member of or acceptable to and subject to the approval of the medical staff of the hospital or medical education and research organization;
- (b) Permit the physician to exercise professional judgment without supervision or interference by the hospital or medical education and research organization; and
- (c) Establish the remuneration of the physician.

See Wis. Stat. § 448.08(5)(a). However, it does not appear that such contract would necessarily have to be in writing.

5. If agreeable to the contracting parties, the hospital or medical education and research organization may charge the patient for services rendered by the physician, but the statement to the patient *shall* indicate that the services of the

physician, who shall be designated by name, are included in the departmental charges. See Wis. Stat. § 448.08(5)(b).

6. Additionally: (i) no hospital or medical education and research organization may limit staff membership to physicians employed under this subsection (see Wis. Stat. § 448.08(5)(c)); and (ii) the responsibility of physician to patient, particularly with respect to professional liability, shall not be altered by any employment contract (see Wis. Stat. § 448.08(5)(d)).

### III. Other Implications of the Corporate Practice Doctrine and Its Exceptions

#### A. Limitation on Choice of Entity For Medical Practices.

1. Wisconsin's Department of Regulation and Licensing ("DRL"), which was disbanded in 2011 and replaced by the Department of Safety and Professional Services ("DSPS"), had for several years published the following FAQ on its website as guidance for physicians:

*Are there any restrictions on a physician practicing medicine under a limited liability company (LLC) or limited liability partnership (LLP)?*

Under Wisconsin law, physicians are prohibited from practicing medicine under a LLC or LLP form of business. Sec. 448.08(4), Wis. Stats., provides that two or more physicians may enter into professional partnerships or service corporations to practice medicine. The allowable form of business entity for physicians has been reviewed by the Wisconsin Attorney General and it was determined that physicians may not organize as business corporations. 75 Op. Att'y Gen. 200 (1986) *Although LLC's and LLP's did not exist at the time of the A.G.'s opinion, the rationale for the opinion would apply equally to those business entities: Physicians are considered members of a learned profession, and their responsibilities for patient health and safety cannot be subordinated to the interests of shareholders or limited by a business entity.*

2. This reasoning appears to be sound with respect to LLCs— inasmuch as LLCs are unique form of unincorporated entity possessed of both corporate and partnership features, one of which is broad limited liability for their members (i.e., no carve-out for a member's own professional negligence, as is the case in a service corporation or general partnership).

3. However, under Wisconsin law, an LLP is, at the end of the day, still a "partnership." Moreover, a partner in a registered LLP remains personally liable for their "own omissions, negligence, wrongful acts, misconduct or malpractice." See Wis. Stat. § 178.12(3). In this respect, an LLP comprised solely of health care professional partners would seem to fall within both the letter and the spirit of the exception under Wis. Stat. § 448.08(4). Thus, the DRL's comparison of an LLP to a regular business corporation or LLC does not seem well-placed.

4. In all events, the recently constituted DSPS has superseded the DRL's previous FAQ—even though the underlying law has not changed—and replaced it with the following “position statement”:

**MAY A PHYSICIAN PRACTICING MEDICINE WITHIN A PARTNERSHIP OR SERVICE CORPORATION?**

Wisconsin Stat. § 448.08(4) provides that two or more physicians may, in the practice of medicine and surgery, enter into professional partnerships or service corporations. Please see Wis. Stat. § 448.08 concerning business practices for physicians and *if additional guidance is necessary, you may wish to consult private counsel.* (Emphasis added.)<sup>1</sup>

**B. Restrictive Covenant Considerations.**

1. Under Wisconsin law, a restrictive covenant “is lawful ... only if the restriction is reasonably necessary for the protection of the employer.” See Wis. Stat. § 103.465. In order to be enforceable under Wisconsin law, a restrictive covenant must: (1) be necessary for the protection of the employer (that is, the employer must have a protectable interest justifying the restriction imposed on the activity of the employee); (2) provide a reasonable time limit; (3) provide a reasonable territorial limit; (4) not be harsh or oppressive as to the employee; and (5) not be contrary to public policy. See *Star Direct, Inc. v. Dal Pra*, 319 Wis.2d 274, 288 at ¶ 20, 767 N.W.2d 898, 905 (2009).

2. As noted above, the Wisconsin Legislature has only seen fit to create three (3) exceptions to the general rule prohibiting the employment of physicians: (i) “professional partnerships” and service corporations formed under Subchapter XIX of Chapter 180 of the Wisconsin Statutes; (ii) “hospitals” as defined in Wis. Stat. § 448.08(1)(a), and (iii) “medical education and research organizations” as defined in Wis. Stat. § 448.08(1)(b).

3. If the “employer” of a physician does not come within one of these statutorily proscribed exceptions—*viz.* if the employer entity is not lawfully allowed to employ a physician in the first place—there is a significant question as to whether that employer can be said to have a protectable interest justifying a restrictive covenant that would prevent the physician from practicing medicine or soliciting patients, since the employer entity clearly cannot do so itself.

4. In *Carter-Shields v. Alton Health Institute*, 777 N.E.2d 948 (Ill. 2002), the Illinois Supreme Court considered this very situation. *Carter-Shields* involved a physician who had entered into an employment agreement containing a non-competition provision with Alton Health Institute, a not-for-profit health care

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<sup>1</sup> See *Positions Statements Related to Physicians Issued by the Medical Examining Board*, available at: <http://165.189.64.111/Documents/Board%20Services/Position%20Statements/Physician.pdf>

organization (“AHI”). Dr. Carter-Shields filed a declaratory judgment action seeking to have her agreement with AHI, including the non-competition provision, declared invalid. The trial court found that Dr. Carter-Shields’ employment agreement was valid and enforceable. On appeal, however, the Fifth District Appellate Court considered whether AHI was precluded from enforcing the restrictive covenant by Illinois’ corporate practice of medicine doctrine.

5. Like Wisconsin, Illinois’ law provides that, except as otherwise permitted by the legislature, corporations are prohibited from providing professional medical services. In the case of *Berlin v. Sarah Bush Lincoln Health Ctr.*, 688 N.E.2d 106, 108 (Ill. 1997), the Illinois Supreme Court carved out an exception to the corporate practice of medicine doctrine for licensed hospitals. The appellate court in *Carter-Shields* held that AHI did not come within this narrow exception. Because AHI was not authorized to practice medicine, the appellate court concluded that the contract between AHI and Dr. Carter-Shields, including the non-competition provision, was void.

6. The Illinois Supreme Court in *Carter-Shields* affirmed the court of appeals conclusion, stating:

[T]he holding in *Berlin* that hospitals are exempt from application of the corporate practice of medicine doctrine was premised on the fact that hospitals are sanctioned under state law to provide medical services to the public and are regulated by state agencies to assure compliance with licensing mandates. Although we noted in *Berlin* that some jurisdictions take the approach that the corporate practice doctrine does not apply to nonprofit hospitals and health associations, we neither discussed the significance of nonprofit status nor relied upon that consideration in arriving at our holding. In fact, we expressly stated in *Berlin* that because the “authorities and duties of licensed hospitals are conferred equally” upon nonprofit and for-profit hospitals, there is “no justification for distinguishing” between licensed entities on the basis of profit. *Berlin*, 179 Ill.2d at 18, 227 Ill.Dec. 769, 688 N.E.2d 106. We therefore reject defendants’ contention that *Berlin* created an exception to the corporate practice doctrine for nonprofit entities.

*See Carter-Shields*, 777 N.E.2d at 958.

7. Moreover, the Illinois Supreme Court in *Carter Shields* noted that the legislature had broad power and discretion to determine what corporate entities it would sanction to provide medical service consistent with the corporate practice of medicine rules, and did not see fit to include such a general “nonprofit” exception—a point they underscored by reference to a then recent act by the Illinois General Assembly to expand the Illinois Hospital Licensing Act to expressly permit “hospital affiliates” to employ physicians. *See id.* at 960.

8. Unlike Illinois today, there is no direct authority in Wisconsin which would seem to permit non-profit entities to employ physicians as a general

matter. Similarly, there is no statutory exception for “affiliates” of hospitals or medical research organizations. However, in OAG 31-86 (Sept. 8, 1986), the unpublished opinion regarding the requirements to qualify as a “medical education and research organizations,” the Wisconsin Attorney General considered the following additional question:

“[D]o the provisions of section [448.08(5)], which permit hospitals and/or medical education and medical research organizations to charge patients for services rendered by employee physicians, similarly permit such charges to be made by *a wholly-owned subsidiary corporation of the hospital and/or organization, the activities of which are interrelated with, necessary to, and supportive of the functions of the parent hospital and/or organization?*”

The Attorney General opined “yes,” as long as the wholly-owned subsidiary corporation *itself* can meet the standards of medical education and research organization – stating:

There is no disservice to the legislative purpose of section 448.08(5) to construe 'organization' to include nonprofit parent and wholly owned subsidiary corporations, *both of which* comply with the requirements ... as a medical education and research organization.

However, this opinion suggests that each of affiliates in question must *independently* qualify for an exception to the corporate practice of medicine – not that affiliates can somehow obtain compliance on an *aggregate* basis.

### C. Effect of Non-Compliance on Other Contracts.

Apart from restrictive covenants (discussed above), if a medical practice is not structured in a permissible entity form or is otherwise not authorized to employ physicians, in violation of Wisconsin’s corporate practice of medicine doctrine, then other agreements related to the provision of professional services by the practice may also be subject to challenge as against public policy.

While there is no Wisconsin authority directly on point, here again, the experience of our neighbors to the South may be illustrative. *Compare, Practice Management, Ltd. v. Schwartz*, 256 Ill. App. 3d 949, 195 Ill. Dec. 192, 628 N.E.2d 656 (1st Dist. 1993) (held that where an agreement between plaintiff management company and licensed ophthalmologist defendants called for 50/50 profit split in contravention of fee splitting statute, the agreement violated public policy and would not be enforced by way of contract damages or *quantum meruit*), *with, Chatham Foot Specialists, P.C. v. Health Care Service Corp.*, 216 Ill. 2d 366, 297 Ill. Dec. 268, 837 N.E.2d 48 (2005) (held that the

failure of professional association to have a current certificate of registration was not the equivalent of it being unlicensed, when its sole shareholder and all of its podiatrist employees valid licenses and, as such, a contract entered into by the professional association with a health insurer should not be rendered unenforceable).

D. Limitations on Ownership and Participation.

1. Section 180.1911(1), Wis. Stat., provides that, subject only to a couple of narrow exceptions, each shareholder, director and officer of a service corporation must at all times be licensed in the same field of endeavor *or* be a "health care professional."

(a) The term "health care professional" is *not* limited to just physicians licensed by the Medical Examining Board; rather, it encompasses all individuals licensed, certified or registered by any of fifteen (15) different professional boards. Thus, a service corporation comprised of neurosurgeons (Wis. Stat. § 180.1901(1m)(b) and massage therapists (Wis. Stat. § 180.1901(1m)(ag)) would seem to be permissible.

(b) An individual who is not appropriately licensed, certified or registered may not have *any part* in the ownership or control of the service corporation. Similarly, a proxy to vote any shares of the service corporation may not be given to a person who is not so licensed, certified or registered

2. However, where a service corporation has only one (1) shareholder, that shareholder shall be the director, president and treasurer of the service corporation – but the other officers need not be licensed, certified or registered. *See* Wis. Stat. 180.1913(1).

E. Risk of Increased Personal Liability.

As noted above, physicians conducting their practice in the service corporation or limited liability partnership form would retain "*un-limited*" personal liability for their own omissions, negligence, wrongful acts, misconduct or malpractice – including the omissions, negligence, wrongful acts, misconduct and malpractice of any person acting under his or her actual supervision and control. Notably, however, they would be relieved of personal liability for the omissions, negligence, wrongful acts, misconduct or malpractice of their fellow shareholders and partners.

If physicians were improperly conducting their practice through an entity form purporting to offer "*unlimited*" limited liability in contravention of the doctrine – e.g. a business corporation or LLC – it is a virtual certainty that a court would blow past this improper "*shield*" and permit a finding of personal liability for a shareholder/member

physician's *own* professional negligence. But what about personal exposure for the liability of another shareholder/member (including, particularly, another *former* shareholder/member)?

Query: Could (or would) a court somehow "deem" the improper use of a business corporation or LLC to be a resulting service corporation or LLP - with limited personal exposure for the professional negligence of another shareholder/member? Or would the court be constrained to disregard the improper form altogether and treat the "organization" as a resulting "general partnership" with no such limitation on liability?

#### IV. Entity Restructuring to Obtain Compliance

##### A. Cross-Species Conversions

1. If a medical practice is structured in an improper entity form - such as a business corporation or LLC - the most straightforward way of resolving any corporate practice of medicine concerns would be to *convert* the entity into a Wisconsin service corporation - which is permitted under the cross-species merger and conversion provisions of Chapters 180 and 183.

2. The principal advantages of *converting* into a service corporation (as opposed to forming a new entity) are (i) a conversion should not disrupt any contracts with non-transferability/anti-assignment clauses (e.g. third-party payor contracts, leases, service agreements, etc.), and (ii) a conversion should not result in any legal transfer of assets, thereby possibly avoiding transfer fees, sales taxes, "due-on-sale" clauses, etc.

3. A cross-species conversion is accomplished (from a business organization standpoint) simply by filing "Articles of Conversion" with the Wisconsin Department of Financial Institutions.

4. For tax purposes, the conversion of a business corporation to a service corporation is of no moment, since the tax classification will not have changed. This would also be true in the case of an LLC that had elected to be treated as a corporation for tax purposes and which later converts to a service corporation.

5. However, if an LLC taxed as a partnership converts to the service corporation form, the following will be deemed to have occurred for tax purposes: (i) the LLC contributes all of its assets and liabilities to the corporation in exchange for the stock of the corporation, and (ii) immediately thereafter, the partnership liquidates, distributing the stock of the corporation to its partners. *See* Rev. Rul. 2004-59, I.R.B. 2004-24 (May 25, 2004). Upon such conversion, the LLC will be treated in the same

manner as an LLC that elects to be treated as an association (and taxed as a C-Corp) under Treas. Reg. § 301.7701-3(c)(1)(i). See *id.*

6. If correctly timed and executed, the resulting corporation from a LLC conversion could elect S-Corp status effective as of the date of conversion with no short taxable year as a C-Corp. See Rev. Rul. 2009-15 (May 7, 2009). This would result in pass-through taxation similar (but not identical to) an LLC taxed as a partnership.

7. If partnership tax treatment—as opposed to S-Corp or C-Corp treatment were desired—the best option would be to restructure as an LLP. However, because Wisconsin’s cross-species merger and conversion statute does not currently permit of a conversion from a corporation or LLC to an LLP, this would unavoidably entail a “transfer” of assets, contracts and liabilities. These may or may not be significant from an income tax perspective, but it could trip non-transferability/anti-assignment clauses and potential sales taxes, transfer fees, “due on sale” clauses and the like that a conversion would likely avoid.

8. A significant concern for medical practices contemplating a change of entity form is the preservation of the entity’s existing “Employer Identification Number” (“EIN”).

## **B. Strategies for preserving an entities existing EIN**

1. When billing Medicare or Medicaid, a medical practice must include its tax identification number—usually an EIN—as well as a separate 10-digit unique identification number for medical billing purposes (the “National Provider Identifier”). Similarly, most private insurers also require a practice to include its EIN as part of the medical claims process.

2. Any change in a practice’s EIN may cause significant delay in the processing of claims reimbursement, or confusion as to payments that results in costly and time-consuming audits and reviews. Moreover, many private insurers—rightly or wrongly—regard a change in EIN as tantamount to a change of the practice itself; with the result that they may use such occasion as an opportunity to require the practice to enter into new payor contract for reimbursement (which may not be as favorable going forward). Accordingly, a practice contemplating a change of entity form should take care to effect any restructuring in such a way as to preserve its existing EIN if at all possible.

3. IRS Publication 1635 - entitled “Understanding Your EIN” - purports to summarize the transactional circumstances under which a variety of entity forms need to obtain a new EIN. Publication 1635 provides the following general rules:

## Corporations<sup>2</sup>

<p>A corporation <i>will</i> need a new EIN if any of the following are true:</p>	<p><b>A corporation will <i>not</i> need a new EIN if any of the following are true:</b></p>
<ul style="list-style-type: none"> <li>• It is a subsidiary of a corporation and currently uses the parent’s corporate EIN</li> <li>• It becomes a subsidiary of a corporation</li> <li>• <i>It becomes a partnership or a sole proprietorship</i></li> <li>• It creates a new corporation after a statutory merger</li> <li>• It receives a new corporate charter</li> </ul>	<ul style="list-style-type: none"> <li>• It is a division of a corporation</li> <li>• After a corporate merger, the surviving corporation uses its existing EIN</li> <li>• It declares bankruptcy</li> <li>• Its business name changes</li> <li>• It changes its location or adds locations (stores, plants, enterprises or branches)</li> <li>• It elects to be taxed as an S corporation by filing Form 2553</li> <li>• After a corporate reorganization, it only changes identity, form or place of organization</li> <li>• It is sold and the assets, liabilities and charters are obtained by the buyer</li> </ul>

(Emphasis added.)

## Partnerships<sup>3</sup>

<p>A partnership <i>will</i> need a new EIN if any of the following are true:</p>	<p>A partnership will <i>not</i> need a new EIN if any of the following are true:</p>
<ul style="list-style-type: none"> <li>• <i>It incorporates</i></li> <li>• <i>One partner takes over and operates as a sole proprietorship</i></li> <li>• The partnership is terminated (no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership) and a new partnership is begun</li> </ul>	<ul style="list-style-type: none"> <li>• It declares bankruptcy</li> <li>• Its name changes</li> <li>• The location of the partnership changes or new locations are added</li> <li>• The partnership terminates under Code Sec. 708(b)(1)(B). A partnership shall be considered terminated if within a 12-month period there is a</li> </ul>

<sup>2</sup> See Publication 1635 at p. 5. See also “Do You Need a New EIN?” <<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Do-You-Need-a-New-EIN>> (last updated May 19, 2014).

<sup>3</sup> See Publication 1635 at p. 6. See also “Do You Need a New EIN?” <<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Do-You-Need-a-New-EIN>> (last updated May 19, 2014).

	sale or exchange of at least 50% of the total interest in partnership capital and profits to another partner. If the purchaser and remaining partners immediately contribute the properties to a new partnership, they can retain the old partnership EIN.
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(Emphasis added.)

4. The seemingly categorical nature of these “general rules” can be misleading. Some of the scenarios described in the foregoing summary as *requiring* a new EIN are, in fact, subject to a number of (unstated) qualifications, exceptions and folkways in the post-“check-the-box” era of cross-species mergers and conversions. There are a couple of fairly common scenarios whereby an entity *can* structure its transition to a different entity form in such a manner as to allow it to retain its existing EIN.

5. The “check-the-box” regulations, and their interplay with the IRS’s other guidance in the areas of tax-free reorganizations and formless conversions, appear to offer a means by which a corporation *can* become a partnership, or a disregarded entity, and still retain its original EIN – seemingly contrary to the general rule as broadly stated in Publication 1635.

6. To begin, Treas. Reg. § 301.6109-1(h)(1) provides that “[a]ny entity that *has* an employer identification number (EIN) *will retain* that EIN if its federal tax classification changes under §301.7701-3” (emphasis added). With this clear statement as a starting point, a couple of possibilities reveal themselves.

7. Moving from a Partnership to a Corporation.

(a) The IRS has ruled that the conversion of an existing “non-LLC” partnership (i.e., a general partnership, limited partnership or LLP) into an LLC also classified as a partnership does *not* require the resulting LLC to get a new EIN.<sup>4</sup> Once the partnership takes the LLC form, a couple further options become available.

(b) If the resulting LLC has more than one member and desires to become a corporation, it can make an election under § 301.7701-3 (via Form 8832) to be classified as an association taxed as a corporation, and retain its original EIN under the rule set forth in § 301.6109-1(h)(1). Once the LLC is a corporation for tax purposes, a subsequent conversion to a corporation under state law would essentially be a name

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<sup>4</sup> See Rev. Rul. 95-37, 1995-1 C.B. 130 (Apr. 24, 1995).

change as far as the IRS is concerned – not a change in tax status – and similarly would not require a change in EIN.<sup>5</sup>

8. Moving from a Corporation to a Partnership.

(a) While this alternative is not currently viable in Wisconsin, inasmuch as corporations cannot currently merge or convert into partnerships (or, domestic partnerships at any rate), such cross-species mergers and conversions are available under the Revised Uniform Partnership Act, Revised Uniform Limited Liability Company Act and conforming Chapter 180 changes being proposed by the State Bar's Business Law Section.

(b) Assuming these revisions become operative, a corporation seeking to change to a qualified partnership form (such as an LLP), should be able to preserve its existing EIN in the following manner:

- (i) Form a new LLC and elect (via Form 8832) to have it taxed as an association effective as of the date of formation.
- (ii) Merge the corporation into the new LLC in a manner that would qualify as an "F" reorganization – with the new LLC as the surviving entity. Per Rev. Rul. 73-526, the surviving LLC should be permitted to retain the EIN of the original corporation merged or converted.
- (iii) Following the "F" Reorganization, the surviving new "association" LLC should be eligible to file another election (via Form 8832) to classify itself as either a partnership or disregarded entity (depending on how many shareholders it has). Because the association LLC already has an EIN – namely the original EIN of the predecessor corporation – the resulting partnership should be permitted to retain this same EIN.<sup>6</sup>

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<sup>5</sup> The IRS's folkways may be even more flexible. See, e.g., Decision Chart at I.R.M. § 3.13.2.25 at Example (k) (authorizing assignment of LLC or partnership EIN to resulting corporation in a conversion upon receipt of documentation of the conversion under state law – without regard to Form 8832).

<sup>6</sup> See Reg. § 301.6109-1(h)(1) ("Any entity that *has* an employer identification number (EIN) *will retain* that EIN if its federal tax classification changes under § 301.7701-3.") (Emphasis added.) See also Decision Chart at I.R.M. § 3.13.2.25 at Example (f) ("If a corporation reorganizes as an association treated as a corporation, and wishes to use the same EIN assigned to them as a corporation and be taxed as a partnership, then they must timely file a Form 8832 electing to be treated as a partnership.")

9. The follow-on “check-the-box” election by the new “association” LLC in the above example is only immediately available because the LLC is a newly formed entity that only made a “check-the-box” election effective on the date of its formation – thus, the 60-month limitation of § 301.7701-3(c)(1)(iv) would not yet apply.<sup>7</sup> Accordingly, the new LLC – post “F” reorganization – would still be able to elect partnership status via another Form 8832 filing and, in the process, retain the EIN of its corporate predecessor. (However, at that point, the resulting partnership itself would then be ineligible to make any further “check-the-box” elections for 60 months.)<sup>8</sup>

10. It is a little less clear whether the same result would obtain in a setting where a corporation simply *converts* into an LLC electing association status, in the manner described in PLR200528021 – i.e., a qualified F reorganization resulting from the conversion of a corporation into an LLC electing association treatment as of the date of conversion. The one exception to the 60-month limitation rule purports to apply to a “newly formed eligible entity” and only where the election is “effective on the date of formation.” However, under many states’ entity conversion statutes, the resulting converted entity is deemed to be the “same” entity without interruption as the converting entity.<sup>9</sup> Accordingly, there is at least a question as to whether an LLC resulting from the conversion of an existing corporation would be regarded as a “newly formed” entity for purposes of applying the exception to the 60 month rule – with the result that new LLC may not be eligible to make a follow-on election into partnership status for another 60 months. However, the administrative folkways in this area appear to be much more flexible, and may render these considerations academic.

11. Section 3.13.2.25 of the Internal Revenue Manual (dated 01-01-14) sets forth the procedures for establishing, maintaining and updating domestic LLCs on its Business Master File. These procedures indicate that, if a corporation files papers with its state of organization to convert to an LLC, the IRS will generally permit the resulting LLC to use the same EIN assigned to them as the corporation – regardless of whether (i) the resulting LLC will be classified as a partnership, a C-corporation, an S-corporation or a disregarded entity, or (ii) whether the conversion to an LLC entails an “F” reorganization. Rather, the focus simply appears to be whether that the IRS receives (i) proof of the corporate conversion, and (ii) a timely filed Form 8832 for the LLC (or Form 2553 in the event of an LLC electing S-corporation status, which shall be deemed to be a Form 8332 filing).<sup>10</sup>

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<sup>7</sup> See Reg. § 301.7701-3(c)(1)(iv) (“An election by a newly formed eligible entity *that is effective on the date of formation* is not considered a change for purposes of this paragraph (c)(i)(iv).”) (Emphasis added.)

<sup>8</sup> See *id.*

<sup>9</sup> See, e.g., *Revised Uniform Limited Liability Company Act (2006)* at § 1046(a).

<sup>10</sup> See Decision Chart at I.R.M. § 3.13.2.25 at Examples (e)(1)-(4).