

Tax Court Decision Serves as Reminder of Need to Take Care in Structuring Management Services Agreements

Providers Should Maintain Records of Actual Services Provided and Actual Time Provided



Ralph Levy, Jr. is of counsel in the Nashville, Tenn. office of Dickinson Wright PLLC. He can be reached at 615/620-1733 or by email at rlevy@dickinsonwright.com. Dickinson Wright PLLC is a full-service law firm with over 400 attorneys with offices in Michigan, Tennessee, Arizona, Nevada, Ohio, Kentucky, Washington, D.C., and Toronto, Ontario.

In a recent decision, *Home Team Transition Management v. Comm'r*, TC Memo 2017-51 (April 6, 2017), the Tax Court denied deductions claimed by a health care services provider (Home Team) that was organized as a "C" corporation for payments made by Home Team to its sole corporate stockholder (Sacer) for management services provided by the four individuals who owned Sacer. During the years in question, Home Team also paid wages to two of the four individuals who owned stock in Sacer for services they provided to Home Team, but Sacer did not pay any wages for services provided by its shareholders.

In two previously published articles in the *Journal of Health Care Compliance*, the author reviewed another case that dealt with the deductibility of management fees paid by a health care services provider (a dental practice) organized as a "C" corporation, *Wiley M. Elick v. Comm'r*, TC Memo 2013-39 (June 3, 2013). On appeal of the Tax Court decision, the Ninth Circuit Court of Appeals agreed with the Tax Court's denial of the deductibility of the management fees. Ultimately, the Supreme Court declined to review the Ninth Circuit decision.¹

In the *Elick* case, the payments were made to a separate corporation that was not the taxpayer's parent but to a corporation under common control with the taxpayer that did not have complete identity of ownership with that of the payor health care services provider. Perhaps due to these factual distinctions, the Tax Court did not cite *Elick*. Instead, the Tax Court referred to another case,² which involved the payment of salary and management fees by a subsidiary to its parent. In *RTS*, the

Tax Court refused to uphold the deductibility of payments that were in direct correlation with the subsidiary's profitability. The Tax Court noted that close scrutiny must be given to salaries paid by a corporation to its officers as employees where the officers set their own compensation.

In *Home Team Transition Management*, Home Team, the subsidiary, paid wages to two of the four owners of Sacer for services they performed for Home Team (one, for administrative services, and the other for health care management services). However, due to cash flow limitations, Sacer did not pay any of its four shareholders for services provided by them. Home Team also deducted payments made to Sacer, its parent, for management services.³ At issue before the Tax Court was the deductibility of the payments made by Home Team to Sacer for management services.

In upholding the Internal Revenue Services' (IRS') denial of the deductibility of the payments, the Tax Court pointed out that the amounts paid by Home Team to Sacer corresponded to the amounts needed by Sacer to service the loans it had incurred to purchase Home Team and were directly correlated to Home Team's profitability and not to any hours of services performed by Sacer employees. In addition, the Tax Court noted that there was no written agreement between Home Team and Sacer for management services; nor did the taxpayer submit any credible evidence that any management services were actually performed by Sacer for Home Team. Moreover, the payments were initially

booked as loans by Home Team to Sacer. As a result, the Tax Court found that the payments were not deductible by Home Team. Although the propriety of Sacer's inclusion of the payments in its income was not before the Court, the Court noted that after the IRS' denial of the deductibility of the management fees paid by Home Team, Sacer had amended its tax returns for the years in question and received a tax refund of the taxes that it had previously paid based on the taxability of those payments.

The *Home Team* decision emphasizes the need for health care providers to take care in documenting management services arrangements, particularly those between affiliated entities or those under common control. The provider of services also should maintain records of the actual services provided and the actual time as to which these services were provided. Readers also should review the author's prior articles in this publication on the *Elick* case for other "rules of the road" in structuring management services arrangements with related entities.

Endnotes:

1. See "Supreme Court Declines to Review Appellate Decision Denying Deductibility of Payments Under Management Services Agreement," *Journal of Health Care Compliance*, September-October 2016, p. 47 and "Tax Court Addresses Tax Deductibility of Payments Under Management Services Agreement," November-December 2013, *Journal of Health Care Compliance*, p. 65.
2. *RTS Inv. Corp. v. Comm'r*, TC Memo 1987-98, as affirmed 877 F.2d 647 (8th Cir. Ct. App. 1989).
3. Sacer initially included these payments in its income for the years in question.