

Tax Court Case Points Out Need for Care in Documenting Payments by Medical Practices

Three Important “Lessons Learned” from Recent Case



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 350 attorneys with offices in Michigan, Tennessee, Arizona, Nevada, Ohio, Washington, D.C., and Toronto, Ontario.

In a recent Tax Court case, *Fisher v. Comm’r*, T.C. Memo. 2014-219, decided on October 16, 2014, the Tax Court found that payments ranging from \$3,000 per month to \$4,000 per month made by a medical practice constituted compensation for services that should be included in income by the individual who received the payments. The Tax Court refused to accept as credible proof submitted by the taxpayer that the payments were made by the medical practice in order that the taxpayer could conduct research needed to write a book on the economics of the practice of medicine. As a result, the Tax Court determined that the payments made by the practice (which totaled almost \$300,000 during the eight years before the Tax Court) were taxable as income to the individual who had received the payments.

In reaching its conclusion, the Tax Court found as credible the testimony of the physician, who was the sole owner of the medical practice that made the payments, and his wife, the practice’s bookkeeper, to the effect that the payments were for services rendered by the taxpayer to the medical practice in conjunction with an insurance audit and in regard to other issues. It did not believe the testimony of the taxpayer, who had not filed federal tax returns for nine years, including the eight years in which the payments were made by the medical practice to the individual.

Although this case addresses the taxability of the payments to the recipient, three lessons can be learned by medical practices that make payments to non-employees.

LESSON #1

Document the grounds for all payments. The Tax Court opinion noted that the taxpayer had testified that

the medical practice had been audited during 2010 and that this was the reason the Internal Revenue Service (IRS) had prepared “forced returns” for the taxpayer, a nonfiler. This aspect of the case points out the need for any medical practice to be “audit ready” if any income tax or employment tax return is reviewed by the IRS. Medical practices should document through contracts or otherwise the reasons for all payments made.

LESSON #2

If the medical practice intends to claim a tax deduction for the payments made to any non-employee, issue a Form 1099 when required to do so. In *Fisher*, the medical practice had not issued a Form 1099-MISC (Miscellaneous Income) to the taxpayer even though the annual payments in each of the eight years were well in excess of the minimum amounts for which such tax reporting was required. The decision did not address the results of the audit of the medical practice. It is highly possible that the violation by the medical practice of the requirement to file Form 1099 information returns was raised in the audit of the medical

practice. In fact, the taxpayer testified that she was not asked to fill out a Form W-9, Request for Taxpayer Identification Number and Certification, until the IRS audit of the medical practice took place.

LESSON #3

Don’t forget the spillover effect of tax audits. As previously noted, the investigation of the taxpayer by the IRS undoubtedly arose from its audit of the medical practice that had made the payments to the individual taxpayer. Similarly, if an insurer is audited by the IRS, it is possible that the tax compliance of all participants in its provider network could be reviewed as well. To avoid any problems if such a spillover audit takes place, each medical practice should properly account for and include in taxable income as appropriate all payments received from its payors.

In summary, the *Fisher* case is instructive for “what not to do” more so than for “what to do.” Regardless, all medical practices should keep these lessons in mind in regard to documentation and tax compliance requirements as to payments made.