

# Corporate Transparency Act and the Friendly Physician Model

*February 1, 2024 – Dorsey Health Law*  
by Randall Hanson and Neal N. Peterson



On  
January  
1, 2024,  
final

## Related People

- Randall Hanson

## Related Capabilities

- Healthcare & Life Sciences
- Healthcare Transactions & Regulations
- Healthcare Litigation
- Medical Devices

regulations issued by the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") went into effect in order to implement the requirements of the Corporate Transparency Act ("CTA"). For background on the CTA and an outline of the final regulations generally, please see this separate Dorsey publication written by members of Dorsey's CTA task force. The purpose of this Dorsey Health Law blog post is to dive deeper into the regulations and discuss the CTA's reporting obligations as they may relate to the friendly physician model used widely across the provider sectors of the health care industry. Note that the CTA and implementing final regulations are both currently in their infancy and new regulatory guidance regarding these rules continues to be released. The analysis presented in this blog post is meant to be general and based on guidance available as of the date of this post only. Applicability of the CTA to any business structure should be assessed on a case-by-case basis.

## Friendly Physician Model

A majority of the United States prohibits corporations owned by non-professional (unlicensed) persons from practicing medicine, e.g., by employing licensed physicians to provide patient care. This doctrine is commonly referred to as the corporate practice of

medicine prohibition (“CPOM”). In order to comply with CPOM, many healthcare companies use a structure commonly referred to as the “friendly physician model”. The friendly physician model involves forming a professional entity (most often a professional corporation or professional limited liability company) owned by a licensed professional that contracts with a management services organization (“MSO”) for administrative services. The contracts entered into with the MSO also typically establish control mechanisms that allow the MSO to make certain non-professional business decisions on behalf of the professional entity, including decisions related to changes in ownership and governance of the professional entity by particular licensed professionals.

## **CTA Beneficial Ownership Reporting**

The CTA requires that all “Reporting Companies” file a report of “Beneficial Owners” to FinCEN. The definition of “Reporting Company” is generally broad and includes all entities formed by filing with a secretary of state. However, this definition is limited by twenty-three (23) exemptions focused on highly regulated industries (e.g., banking; insurance; but not health care providers generally) and large organizations. If an entity qualifies as a Reporting Company but does not meet one of the twenty-three (23) exemptions, it must file a report with FinCEN that includes information on such entity’s Beneficial Owners, defined broadly as any “individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise (i) exercises substantial control over the entity; or (ii) owns or controls not less than 25 percent of the ownership interests of the entity.”<sup>[1]</sup>

## **Exemption from CTA Reporting for Friendly Physician Model Professional Entities**

The friendly physician model’s unique structure requires a nuanced analysis of the CTA and its implementing regulations in order to determine whether Beneficial Owner reporting is required for a professional entity formed within an organization’s friendly physician model. First, a few assumptions:

1. The MSO contracting with a professional entity may itself be considered exempt from CTA reporting (likely under either the “large company” or “subsidiary” exemptions, discussed further below).
2. The contracts entered into between the MSO and a professional entity include terms that establish control mechanisms that allow the MSO to make certain non-professional business decisions on behalf of the professional entity, including decisions related to changes in all ownership and governance of the professional entity by particular licensed professionals.

Of the twenty-three (23) exemptions from CTA reporting available, only two (2) can likely be considered for a professional entity formed within an organization’s friendly physician model: the “large company” exemption or the “subsidiary” exemption.

### ***I. Large Company Exemption***

The large company exemption is available for any entity that “(i) employs more than 20 employees on a full-time basis in the United States; (ii) filed in the previous year Federal

income tax returns in the United States demonstrating more than \$5,000,000 in gross receipts or sales in the aggregate, including [consolidated receipts]; and (iii) has an operating presence at a physical office within the United States.”<sup>[2]</sup> While a professional entity formed within an organization’s friendly physician model may be able to demonstrate the gross receipts necessary for this exemption, many such professional entities may not be able to demonstrate direct employment of 20 employees. If a professional entity can meet this exemption, then such professional entity is not required to report Beneficial Owner information to FinCEN.

## *II. Subsidiary Exemption*

The subsidiary exemption is available to any entity “of which the ownership interests are owned or controlled, directly or indirectly, by 1 or more [already exempt] entities.”<sup>[3]</sup> While the MSO contracting with a professional entity formed within an organization’s friendly physician model cannot be the direct owner of a professional entity (as such would be a violation of CPOM), it is possible that the MSO’s contracting relationship with the professional entity could be considered to establish at least indirect control over the professional entity sufficient to meet the subsidiary exemption.

Neither the CTA nor the implementing regulations expressly detail what “control” means with respect to the subsidiary exemption. However, the implementing regulations do provide additional definitions for “control” in the context of Beneficial Ownership, and preamble language from FinCEN’s final regulations suggests it would be reasonable to review such “control”-related definitions in analyzing the subsidiary exemption. In rejecting rule commenters’ suggestions to include “wholly” controlled within the regulation’s subsidiary exemption language, FinCEN states that the use of the term “control” already “covers the intended concept of control set out in the CTA.” In so stating, FinCEN indicates that the concept of “control” should be consistent throughout the implementation of the CTA.

FinCEN’s CTA implementing final regulations provide the following, in part, related to the concept of “control”:

- “an individual exercises substantial control over a reporting company if the individual: . . . has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body); or . . . directs, determines, or has substantial influence over important decisions made by the reporting company.”
- FinCEN clarifies that substantial control can be exercised indirectly “through . . . any other contract, arrangement, understanding, relationship or otherwise.”

Further, FinCEN’s January 12, 2024 FAQ update provides that “control” is only established for purposes of the subsidiary exemption if control is maintained over *all* of the ownership interests.

Therefore, with reference to the assumptions placed above, it would be a reasonable conclusion that a professional entity formed within an organization’s friendly physician model could be exempt from CTA reporting by way of being indirectly controlled by the MSO and therefore a subsidiary of an already exempt entity.

In the event a professional entity formed within an organization's friendly physician model is found to be a Reporting Company under the CTA, additional case-by-case analysis of who the Beneficial Owners are would be necessary.

If you have any questions about the CTA's potential application to a friendly physician model, reach out to your regular Dorsey attorney or to any member of the Dorsey & Whitney LLP Healthcare Transactions and Regulations practice group.

*Erin Bryan, a Partner in Dorsey's Consumer Financial Services Group and a Member of the firm's CTA Working Group, provided substantial consultation for this blog post.*

[1] 31 U.S. Code § 5336(a)(3)(A)

[2] 31 U.S. Code § 5336(a)(11)(B)(xxi)

[3] 31 U.S. Code § 5336(a)(11)(B)(xxii)