

Employee or Independent Contractor? IRS Scrutinizes Physician Employment Status

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Practice Area: Health Industry Labor, Employment and Immigration

The IRS continues to seek to reclassify certain physicians as employees rather than independent contractors – a trend that is illustrated by two recently released private letter rulings. This issue arises with hospital based physicians and in some of the new Integrated Delivery Systems.

This reclassification can create new and increased costs for the employers involved, including tax withholding, payment of social security and federal unemployment taxes, as well as exposure to penalties and interest.

The IRS relies heavily on four criteria to determine whether an individual is an employee or an independent contractor:

- Whether the individual has become integrated into the organization;
- Whether the work is substantial, regular, and continuous;
- Whether the individual is subject to the direction and control of the organization; and
- Whether the individual has the right to participate in the organization's fringe benefits.

In both rulings, the IRS reclassified the physicians as employees even though they shared some of the features commonly associated with independent contractors. The IRS found that other employment-related factors outweighed those features.

The first ruling involved a panel of physicians that had entered into a contract with a hospital for the interpretation of electro-cardiograms. The panel members purchased their own professional liability insurance, did not participate in any hospital benefit plans, and were free to market their services elsewhere.

The IRS ruled that the panel members were employees of the hospital for three reasons. First, they were paid a flat fee for each interpretation and, therefore, did not have their own money at risk.

Second, the EKG interpretations were necessary every day, establishing a continuing relationship.

Third, the EKG interpretations were a key part of the hospital's services.

According to the IRS, these factors demonstrated that the EKG panel members were under the direction and control of the hospital, despite the fact that they purchased their own insurance and did not participate in benefit programs.

The second ruling involved an individual physician who had been appointed medical director of a long-term care nursing home. The medical director maintained her separate practice, established her own hours, and was not included in benefit plans.

Again, the IRS determined that she was an employee rather than an independent contractor because the employer controlled the nursing home and the physician's work.

She was required to work a minimum number of hours and submit regular reports, which indicated integration into and control by the hospital. The fact that the medical director was paid a set amount each month and did not have any money at risk was also persuasive.

Reclassifying independent-contractor physicians as employees can create new complications or make an arrangement unworkable. Therefore health-care providers need to assess the impact of such contracts carefully.

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