
Medicare

Provider Reimbursement Manual

Part 1, Chapter 9, Compensation of Owners

Department of Health & Human Services (DHHS)
Centers for Medicare & Medicaid Services (CMS)

Transmittal 474

Date: July 21, 2017

HEADER SECTION NUMBERS

Table of Contents
901 - 906.4

PAGES TO INSERT

9-1 - 9-2 (2pp.)
9-3 - 9-10 (8 pp.)

PAGES TO DELETE

9-1 - 9-2 (2 pp.)
9-3 - 9-8 (6 pp.)

CLARIFIED/UPDATED MATERIAL--*EFFECTIVE DATE*: The inflation factors in section 905.6 are applied on a calendar year basis. The guidelines in section 905.7 are provided beginning with cost reporting periods beginning in Federal Year (FY) 2009.

Section 905.6, Inflation Factor, provides for calendar year (CY) inflation factors to update previous years' reasonable compensation ranges. The factor is from the cost category Professional Fees: Labor Related in the CMS Prospective Payment System Hospital Input Price Index. The data in the Input Price Index is taken from actual data for the most recent year from the Employment Cost Index (ECI) for Professional and Related Services published by the Bureau of Labor Statistics. The data for years prior to 2006 was from the ECI for Professional and Technical Workers. In this transmittal, the factor for CY 2015 has been added and the factor for CY 2005 has been deleted. The factors are applied on a calendar year basis.

Section 905.7, Guidelines for Physician Owner Compensation for Rural Health Clinics, provides guidance in evaluating the reasonable cost of physician owner compensation for rural health clinics. The factors are applied on a calendar year basis. The Physician Owner Compensation Reasonable Cost Guidelines for Rural Health Clinics table provides ranges, by year, for FY 2009 through FY 2014.

DISCLAIMER: The revision date and transmittal number apply to the red italicized material only. Any other material was previously published and remains unchanged.

Chapter 9
COMPENSATION OF OWNERS

	<u>Section</u>
<u>General</u>	
Principle	900
Application	901
<u>Definitions</u>	
Definitions	902
Compensation-Sole Proprietorships and Partnerships	902.1
Compensation-Corporations	902.2
Reasonableness	902.3
Necessary	902.4
Persons Related to Owner	902.5
Trusts	902.6
Compensation for Persons Related to Owner	902.7
Proprietary Provider	902.8
<u>Reasonable Compensation</u>	
Criteria for Determining Reasonable Compensation-General	904
Factors to be Considered in Determining Comparability of Institutions	904.1
Factors to be Applied in Evaluating Compensation Within Range for Comparable Institutions	904.2
Procedures for Determining Reasonable Compensation	905
General	905.1
Surveys	905.2
Uniform Approach	905.3
New Providers and Future Surveys	905.4
Few Similar Providers in an Area	905.5
Inflation Factor.....	905.6
<i>Guidelines for Physician Owner Compensation for Rural Health Clinics.....</i>	<i>905.7</i>
<u>Types of Compensation</u>	
Types of Compensation-Corporations	906
Other Types of Compensation	906.1
Subchapter S Corporations	906.2
Director's Fees and Consultant's Fees	906.3
Unpaid Compensation	906.4
Compensation-Sole Proprietorships and Partnerships	907

This page intentionally left blank.

900. PRINCIPLE

A reasonable allowance of compensation for services of owners is an allowable cost, provided the services are actually performed in a necessary function (42 CFR 413.102).

901. APPLICATION

The allowance of compensation for services of sole proprietors and partners is the reasonable value of the services furnished. The test of reasonableness applies to the actual compensation of all individuals performing services in connection with the operation of a provider including: (1) employees, officers, and directors owning stock in closely-held corporations; (2) employees, officers, and directors with a substantial ownership or equity in public corporations; and (3) certain employees of trusts. (See §902.6).

902. DEFINITIONS

902.1 Compensation-Sole Proprietorships and Partnerships.--The allowance of compensation for services of sole proprietors and partners is the amount determined to be the reasonable value of the services furnished regardless of whether there is an actual distribution of the profits of the business or payment made to the sole proprietor/partner. (See §907.)

902.2 Compensation-Corporations.--For purposes of determining whether the total compensation paid to an owner is reasonable, compensation as defined herein means remuneration paid to an owner regardless of the form in which it is paid. (See §§906 and 906.1.) Compensation may be included in allowable provider cost only to the extent that it represents reasonable remuneration for managerial, administrative, professional, and other services related to the operation of the facility and furnished in connection with patient care. Services furnished in connection with patient care include both direct and indirect activities in the provision and supervision of patient care, such as administration, management, and supervision of the overall institution. Costs of activities not related to either direct or indirect patient care, e.g., those primarily for the purpose of managing or improving the owner's financial investment, are not recognized as an allowable cost. Compensation of a physician owner of a facility is subject to an allocation between professional and provider components. (See §2108 and §2182.)

Payments found to represent a return on equity capital are not compensation and are in no event allowable as an item of reimbursable cost. Nor are such payments considered as compensation for purposes of determining the reasonable level of reimbursement of the owner.

902.3 Reasonableness.--Reasonableness requires that the compensation allowance be such an amount as would ordinarily be paid for comparable services by comparable institutions depending upon the facts and circumstances of each case. Reasonable compensation is limited to the fair market value of services rendered by the owner in connection with patient care. Fair market value is the value determined by the supply and demand factors of the open market.

902.4 Necessary.--Necessary means that had the owner not furnished the services, the institution would have had to employ another person to perform those services. The services must be pertinent to the sound conduct and operation of the institution.

902.5 Persons Related to Owner.--Compensation paid to an employee who is an immediate relative of the owner of the facility is also reviewable under the test of reasonableness. For this purpose, the following persons are considered immediate relatives: (1) husband and wife; (2) natural parent, child, and sibling; (3) adopted child and adoptive parent; (4) stepparent, stepchild, stepbrother, and stepsister; (5) father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, and sister-in-law; *and*, (6) grandparent and grandchild.

902.6 Trusts.--Where a trust operates an institution or has an interest in the corporation or partnership operating the facility, the compensation of an employee who is the settlor or grantor of the trust, a trustee, or a beneficiary of the trust, is subject to the test of reasonableness.

902.7 Compensation for Persons Related to Owner.--The actual compensation to an immediate relative of an owner (as described in §902.5) is subject to the test of reasonableness. No cost may be imputed for the value of these services.

902.8 Proprietary Provider.--A proprietary provider is a provider organized and operated with the expectation of earning a profit for the owners (as distinguished from a provider organized and operated on a nonprofit basis).

904. CRITERIA FOR DETERMINING REASONABLE COMPENSATION-GENERAL

In general, the determination as to the reasonableness of a person's compensation is made by comparing it with the compensation paid to other individuals in similar circumstances. To obtain uniformity in application of the principle, the contractor (1) identifies compensation paid to individuals other than owners by comparable institutions in the same geographical *area, and* (2) applies a set of criteria based on the qualifications and responsibilities of the owner to determine his placement within the range.

In establishing the ranges, abnormally low amounts of compensation sometimes received by employees of religiously sponsored providers may be ignored since circumstances led to the establishment of their rate of pay which are not applicable to other persons. Although contractors are to be guided by the established ranges in evaluating the reasonableness of owner compensation, there may be special circumstances where a contractor, on the basis of its judgment, allows an amount that is outside the established range. This might occur where the provider has certain characteristics or the owner has special qualifications and experience which would make a comparison with other institutions and individuals unrealistic.

904.1 Factors to be Considered in Determining Comparability of Institutions.--There are a number of factors involved in the determination of the comparability of institutions which include, but are not necessarily limited to, the following:

A. The Size of an Institution.--The size of institutions will generally be measured by the number of beds; however, because of differences in occupancy rates, in some situations the number of patient days for the period in question may also be used in determining whether particular providers are comparable in size. Where only a portion of the total beds of an institution are certified, the provider should be classified by the total beds available since the compensation paid administrators is based on services rendered to the entire facility. Only a portion of the allowed compensation would be allocated to the certified part of the institution. For home health agencies, size will be measured by the number of visits.

B. Classification of Institutions.--Institutions should be classified by the type and range of services offered. The type of services has reference to the nature of the services rendered; i.e., medical, surgical, rehabilitative, etc. The range of the services means the extent to which the particular kind of service can be rendered. For example, for rehabilitative services, the range of services refers to the amount and kind of physical therapy available, whether speech therapy is available, etc. In considering the type and range of services rendered, emphasis will be given to those services available in the institution rather than services which are available only when arranged for with other organizations by the provider.

C. Number and Types of Personnel Employed.--This factor refers to the number of personnel employed in the various professional and nonprofessional categories.

D. Geographical Location.--In determining the comparability of facilities, geographical location is a consideration. Since consideration is given to the area in which the institution is located and whether it is in an urban, suburban, or rural setting, differences in prevailing living and wage costs are recognized.

904.2 Factors to be Applied in Evaluating Compensation Within Range for Comparable Institutions.--The factors that are considered in determining the reasonableness of owner compensation within the range established for a class of institution include the following:

A. The qualifications of the owner, including *the owner's* educational attainment and experience in similar responsible positions. Education and experience are pertinent only as they relate to the job being performed and services being rendered. Where an owner-administrator is also a physician, the services evaluated are administrative in nature rather than the actual practice of medicine. Therefore, the compensation allowed is based on the compensation nonphysician administrators receive rather than on the rate physicians receive for their professional services.

B. The number and types of professional and other personnel supervised by the owner.

C. The duties and responsibilities of the owner and the actual services rendered.

1. Information as to the owner's actual duties, responsibilities, hours, and days regularly worked, etc., should be obtained. Compensation for full-time service requires that at least 40 hours per week be devoted to the duties of the position for which compensation is required. Owners devoting less than 40 hours per week to the position will be compensated on a proportionate basis, with 40 hours per week considered to be the full-time *for* such proportionate compensation.

2. The fact that an owner may have potential supervisory and managerial authority *as well as* responsibility for an institution is not as important as the manner in which authority and responsibility is actually exercised. For example, another individual, perhaps with the designation of assistant administrator, might perform most day-to-day managerial and supervisory functions in an institution. In such case, the right of the owner-administrator to overrule decisions does not constitute a basis for recognition of compensation comparable to administrators in other similar institutions.

D. Whether the owner performs services for any other institutions or is engaged in any other occupation.

1. *When* an owner performs services for several institutions, *the owner presumably* spends less than full time (i.e., at least less 40 hours a week) with each institution. In such cases, allowable compensation shall reflect an amount proportionate to a full-time basis.

2. If an owner is engaged in another activity, such as an owner-administrator also having a private medical practice, *the owner* ordinarily could not render full-time services as administrator of the institution.

905. PROCEDURES FOR DETERMINING REASONABLE COMPENSATION

905.1 General.--Contractors have the responsibility for evaluating the reasonableness of owner compensation in terms of the criteria provided in §§904.1 and 904.2. On the basis of information obtained by surveys of providers, *the contractors establish* ranges of compensation for comparable institutions. Contractors will utilize these ranges both for final settlement and when setting interim rates.

Where an owner indicates *they* function in an executive role other than as administrator (e.g., president, executive director, etc.), the contractor will ascertain the owner's actual duties and categorize by the nature of the services rendered in connection with patient care rather than by the various titles administrators might have. Contractors will consolidate virtually identical or similar services to permit the establishment of realistic ranges.

Where an owner occupies a position other than as administrator (e.g., nursing supervisor), the determination of the reasonableness of the compensation may be much simpler since there would tend to be more uniformity in the type of service rendered in a position other than as an administrator.

905.2 Surveys.--Surveys shall include all proprietary institutions and a sufficient number of comparable nonproprietary institutions in the same geographical area so that an adequate comparison can be made. The comparison should take into consideration the services compensation of non-owner administrators of proprietary and nonproprietary facilities.

905.3 Uniform Approach.--The application of this policy requires a consistency in the development of ranges of compensation for services in comparable situations. To insure that this consistency is achieved, the regional offices have the responsibility for coordinating contractor activities.

There may be situations in which an individual has an ownership interest in providers serviced by different contractors. It is appropriate for contractors to inquire of the owner whether such situation does exist and, if so, to coordinate its determination with the other contractor(s).

905.4 New Providers and Future Surveys.--*When* a proprietary provider first enters the program, the owner compensation is evaluated by its contractor in terms of the ranges of compensation established for comparable institutions. After a period of *time, contractors may need* to resurvey their providers because of changes in compensation levels and changes in the duties and responsibilities of the owners.

905.5 Few Similar Providers in an Area.--Where there are few comparable institutions in an area, it may be difficult for a contractor to evaluate the reasonableness of an owner's compensation. In such situations, the contractor may need to obtain information about the ranges of compensation established for comparable institutions in nearby or similar areas. Another method is to use the ranges established for another class of institution and adjust the ranges accordingly. For example, the contractor may, on the basis of its analysis and judgment, establish as reasonable compensation in a given skilled nursing facility (SNF) an appropriate proportion of the compensation paid to administrators of comparably sized hospitals in the same area. However, *when* this approach is taken, the fact that hospitals are generally more complex institutions than SNFs is reflected in the *contractor's determination of the reasonableness of owner compensation.*

905.6 Inflation Factor.

Contractors apply an inflation factor to update ranges of reasonable compensation determined for previous years. The CMS furnishes an annual calendar year (CY) inflation factor for this purpose. Following are the CY factors for recent years:

2006 - 3.4%; 2007 - 3.7%; 2008 - 3.0%; 2009 - 1.7%; 2010 - 1.5%; 2011 - 2.0%; 2012 - 2.0%; 2013 - 1.9%; 2014 - 1.9%; *2015 - 1.8%; 2016 - 1.6%*

905.7 Guidelines for Physician Owner Compensation for Rural Health Clinics.

Contractors are responsible for evaluating the reasonableness of physician owner compensation for rural health clinics (RHC) by establishing ranges of compensation for comparable institutions as provided in §905.1. Alternately, contractors may use ranges developed by CMS and presented in the following table, Physician Owner Compensation Reasonable Cost Guidelines for Rural Health Clinics. Note that the ranges set forth in the following table are only for determining the reasonableness of physician owner compensation for the purposes of cost reimbursement of RHCs and are not for the purposes of complying with the physician self-referral law (42 USC 1395nn) and regulations (42 CFR Part 411, Subpart J).

CMS developed ranges of reasonable cost for physician owner compensation from comparable RHCs using RHC Medicare cost reports beginning in Fiscal Year (FY) 2012. CMS analyzed physician compensation, for both hospital-based and freestanding RHCs, that included net expenses for physicians and FTE data, to develop ranges of reasonable cost for physician owner compensation for RHCs. In establishing the ranges, abnormally low and high amounts (less than \$90,000 and in excess of \$600,000) were trimmed from the data.

CMS aggregated the data by divisions and regions, as defined in the U. S. Census Bureau, to provide ranges of reasonable cost for physician owner compensation for RHCs in the same geographical areas.

CMS trended the data back to 2009 and forward to 2014 using inflation factors from §905.6. The ranges determined as a result of the analysis are presented in the Physician Owner Compensation Reasonable Cost Guidelines for Rural Health Clinics table. The ranges are not intended as limits or caps on physician owner compensation, but may be used as a guide in evaluating the reasonableness of physician owner compensation. On the basis of its judgment and with proper justification, a contractor may allow an amount outside the ranges in the table.

For example, the comparison of physician owner compensation for a cost report beginning in FY 2011 for a provider located in Division 9 might be:

For FY 2011, the provider claimed physician owner compensation for one FTE in the amount of \$315,144. Referring to the Physician Owner Compensation Reasonable Cost Guidelines for Rural Health Clinics table, the FY 2011 reasonable physician owner compensation for Division 9 ranges from \$285,398 to \$312,347. Comparing the \$315,144 to the Division 9 range reveals the physician owner compensation claimed exceeds the top of the range. The contractor may hold the provider to the Division 9 range or, on the basis of its judgment and with proper justification may allow the amount claimed as physician owner compensation.

Alternately, reasonable physician owner compensation may be compared on a regional level. Referring to the Physician Owner Compensation Reasonable Cost Guidelines for Rural Health Clinics table, the FY 2011 reasonable physician owner compensation for Region 4 ranges from \$279,756 to \$310,782. Comparing the \$315,144 to the Region 4 range reveals the physician owner compensation claimed exceeds the top of the range. The contractor may hold the provider to the Region 4 range or, on the basis of its judgment and with proper justification may allow the amount claimed as physician owner compensation.

**Physician Owner Compensation Reasonable Cost Guidelines for Rural Health Clinics
By Census Bureau Regions and Divisions
Per FTE**

Region	Division	2009		2010		2011		2012		2013		2014		
		Factor*: →												
		0.017		0.015		0.020		0.020		0.019		0.019		
* Source: §905.6.		Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	Min	Max	
1	1	New England	\$275,890	\$306,762	\$280,029	\$311,364	\$285,629	\$317,591	\$291,342	\$323,943	\$296,877	\$330,098	\$302,518	\$336,370
	2	Middle Atlantic	\$213,095	\$223,657	\$216,292	\$227,012	\$220,618	\$231,552	\$225,030	\$236,183	\$229,306	\$240,670	\$233,663	\$245,243
Subtotal - Region 1: Northeast		\$252,636	\$264,593	\$256,425	\$268,562	\$261,554	\$273,933	\$266,785	\$279,412	\$271,854	\$284,721	\$277,019	\$290,131	
2	3	East North Central	\$251,684	\$276,027	\$255,459	\$280,167	\$260,569	\$285,771	\$265,780	\$291,486	\$270,830	\$297,024	\$275,976	\$302,667
	4	West North Central	\$266,258	\$285,384	\$270,252	\$289,665	\$275,657	\$295,458	\$281,170	\$301,367	\$286,512	\$307,093	\$291,956	\$312,928
Subtotal - Region 2: Midwest		\$260,249	\$281,442	\$264,153	\$285,663	\$269,436	\$291,376	\$274,825	\$297,204	\$280,047	\$302,851	\$285,368	\$308,605	
3	5	South Atlantic	\$218,079	\$233,894	\$221,350	\$237,402	\$225,777	\$242,150	\$230,293	\$246,993	\$234,669	\$251,686	\$239,128	\$256,468
	6	East South Central	\$250,876	\$268,628	\$254,640	\$272,658	\$259,732	\$278,111	\$264,927	\$283,673	\$269,961	\$289,063	\$275,090	\$294,555
	7	West South Central	\$233,620	\$244,568	\$237,124	\$248,236	\$241,867	\$253,201	\$246,704	\$258,265	\$251,391	\$263,172	\$256,167	\$268,172
Subtotal - Region 3: South		\$236,132	\$245,690	\$239,674	\$249,375	\$244,468	\$254,363	\$249,357	\$259,450	\$254,095	\$264,380	\$258,923	\$269,403	
4	8	Mountain	\$261,423	\$298,011	\$265,344	\$302,481	\$270,651	\$308,530	\$276,064	\$314,701	\$281,309	\$320,680	\$286,654	\$326,773
	9	Pacific	\$275,667	\$301,697	\$279,802	\$306,223	\$285,398	\$312,347	\$291,106	\$318,594	\$296,637	\$324,647	\$302,273	\$330,815
Subtotal - Region 4: West		\$270,217	\$300,186	\$274,270	\$304,689	\$279,756	\$310,782	\$285,351	\$316,998	\$290,773	\$323,021	\$296,298	\$329,158	

Census Bureau Divisions:

New England Division: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont

Middle Atlantic Division: New Jersey, New York, Pennsylvania

East North Central Division: Illinois, Indiana, Michigan, Ohio, Wisconsin

West North Central Division: Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota

South Atlantic Division: Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, West Virginia

East South Central Division: Alabama, Kentucky, Mississippi, Tennessee

West South Central Division: Arkansas, Louisiana, Oklahoma, Texas

Mountain Division: Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, Wyoming

Pacific Division: Alaska, California, Hawaii, Oregon, Washington

906. TYPES OF COMPENSATION - CORPORATIONS

As indicated in §902.2, compensation for the necessary services of a stockholder-employee or an individual described in §901 (other than sole proprietors and partners) includes:

- Salary amounts paid for managerial, administrative, professional, and other services;
- Amounts paid by the institution for the personal benefit of the owner (see §906.1);
- The costs of assets and services which the owner receives from the institution (see §906.1); and
- Deferred compensation. (See §2140.)

Any payments to an owner in excess of a reasonable level do not constitute compensation or any other allowable cost.

906.1 Other Types of Compensation.--There may be instances in which an owner is receiving compensation in a form that, without close scrutiny, might not be recognized as compensation (e.g., fringe benefits). Compensation to an owner may include (1) supplies and services for the personal use of the owner, (2) special merchandise ordered from wholesalers for the owner's personal use, (3) wages of a domestic or other employee who works in the home of the owner, (4) personal use of a car owned by the business, (5) personal insurance premiums paid for the owner, and (6) other fringe benefits as described in §2144.

Any of the above payments must be included in the owner's total compensation to determine its reasonableness when such payments meet the requirements for being categorized as fringe benefits under the definition given in §2144.1. If the requirements of that section are not met, these types of payments cannot be considered compensation.

906.2 Subchapter S Corporation.--Under Federal income tax law, certain corporations can elect to be treated for tax purposes as a partnership. This election, however, has no effect on reimbursement under the Medicare program, and an owner of a Subchapter S corporation is not considered a partner for purposes of this principle.

906.3 Director Fees and Consultant Fees.--All payments by a provider to an owner which are claimed as an allowable cost are included in the owner's total compensation for purposes of determining the reasonableness of the cost claimed. This includes fees received by an owner, regardless of the label placed on them, such as consultant or director fees. The determination as to the reasonableness of such compensation is made by comparing it with amounts paid by comparable institutions for comparable services performed by their employees, rather than by considering the amounts that outside consultants receive.

906.4 Unpaid Compensation--See §2146.2B.

General--The compensation of stockholder-employees and individuals described in §901 (other than sole proprietors and partners) is included for a cost reporting period if earned within the period, even if not paid until after the close of the period. However, payment must be made (whether by check or other negotiable instrument, cash or legal transfer of assets such as stocks, bonds, real property, etc.) within 75 days after the close of the period. Where payment is made by check or other negotiable instrument (e.g., a promissory note), these forms of payment must be liquidated through an actual transfer of the provider's assets within 75 days after the close of the period in order to meet the requirements of this section. If payment, including the liquidation of negotiable instruments, is not made within the cost reporting period, or within 75 days thereafter, the unpaid compensation is not includable in allowable costs either in the period when earned or in the period when actually paid.

907. COMPENSATION-SOLE PROPRIETORSHIPS AND PARTNERSHIPS

A. General--The allowance of compensation for sole proprietors and partners is the value of the services rendered by the owner. Such an amount may or may not be represented as actual payments made to the owner. There is no direct relationship between the compensation allowance of the owner and the amount of operating profit (or loss) of the facility.

In determining the allowance, the contractor is responding to a claim for the value of the services of the owner. That is, the institution will include in its statement of reimbursable cost an allowance for the value of the owner's services and the contractor evaluates the reasonableness of this claim by applying the criteria in this chapter.

B. Actual Payments Made--Where a provider has claimed as some other cost (for example, see §906.1) an amount paid to a sole proprietor or partner, such amount is combined with the allowance claimed by the provider for the owner's services. This total is then used for determining the reasonableness of the compensation allowance claimed.

C. Other Considerations--Since the compensation allowance for sole proprietors and partners is dependent upon the value of the necessary services rendered, no allowance is granted where such services are not actually rendered. This is true even if an owner is receiving payments from the provider. Therefore, although a partnership agreement might provide for retired partners to continue to receive a share of the partnership profits even though they are not rendering any services, such payments are not considered allowable costs under the program.

D. Corporation is Partner--Where a corporation is a partner in a participating provider, the allowance of compensation for the services of stockholder employees of the corporation is limited to the actual remuneration paid. In contrast to sole proprietors and partners, these individuals do receive actual compensation for their services, separate and apart from any distribution of profits made to them by virtue of their ownership interest in the corporation. The compensation paid by the corporation is subject to the test of reasonableness in evaluating the partnership's claimed allowance. Further, since the corporation is considered related to the provider within the meaning of chapter 10, Cost to Related Organizations, the provider also cannot claim amounts for services performed by other employees of the corporation which are in excess of the actual remuneration paid.