

KAMENSKY RUBINSTEIN HOCHMAN & DELOTT, LLP

Winter 2005/2006 LAW UPDATE

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Philip Pomerance has joined the Firm's Health Care Law Group. He represents physicians and physician groups, pharmacies, senior living providers, health care management companies, and other health care providers in matters of health care, corporate, not-for-profit and administrative law. His expertise includes advising parties to mergers and acquisitions in the health care industry and providing counsel in the increasingly complex regulation of the business of health care. He practices in the area of health care fraud and abuse regulation and defense, and he also provides advice to lawyers and health care providers on ethical issues.

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Tax: Annual Gifts; Drugs Imported from Canada are not Deductible; Roth Contributions to 401(k) Plans; Cafeteria Plan Modifications.

TAX: IRS: COST OF DRUGS IMPORTED FROM CANADA NOT DEDUCTIBLE

On March 14, 2005, IRS Information Letter 2005-0011 reported that the cost of drugs imported by an individual from Canada is not deductible. The IRS stated in the Letter that deductions for medical expenses are not permitted for illegal operations, treatments or drugs and that it is illegal for individuals to import drugs from other countries.

The Information Letter notes that the Medicare Modernization Act of 2003 permits the government to grant waivers that allow individuals to import drugs from Canada once it has been determined that this is safe and cost-effective. However, Health and Human Services ("HHS") concluded that such a program would not lead to significant savings for consumers and that it would be difficult to ensure the safety and effectiveness of drugs imported by individuals.

While participants may request health savings accounts ("HSA") and flexible savings accounts ("FSA") be used to reimburse the cost of prescription drugs imported from Canada, a similar analysis would apply and therefore such expenses will not be reimbursable.

EMPLOYMENT LAW: ILLINOIS SUPREME COURT RESOLVES DISPUTE REGARDING EFFECT OF PROFESSIONAL CORPORATION'S FAILURE TO REGISTER WITH IDFPR

On September 22, 2005, the Illinois Supreme Court issued an opinion which conclusively resolved a dispute between the lower appellate courts regarding whether a failure to register as a professional service corporation with the Illinois Department of Financial and Professional Regulation ("IDFPR") precludes the

corporation from enforcing its contractual rights. The Supreme Court in *Chatham Foot Specialist, P.C. v. Health Care Service Corporation*, held that the failure to register with the IDFPR, as required by the Professional Service Corporation Act ("Act"), does not prohibit a corporation from enforcing its contractual rights.

Following the decision of the Second Appellate District in the case of *Riggs v. Woman to Woman Obstetrics and Gynecology, P.C.*, in which the KRHD successfully represented the professional corporation, the Supreme Court held that the registration requirement under the Act was not enacted for the benefit of the public, and therefore the mere failure to register did not excuse a party from performing its contracts with the professional corporation.

In reaching that decision, the Supreme Court specifically held that the corporate practice of medicine doctrine, as interpreted by its earlier decision in the *Carter-Shields* case, was not implicated because the professional corporation was owned and operated by a licensed individual and thus there was no danger of lay control over professional judgment. Accordingly, although the Supreme Court has conclusively determined the registration issue, the firm anticipates that there will be significant litigation in the future over what constitutes impermissible lay management or control of a professional corporation.

If your practice relies significantly upon unlicensed individuals for the management or operation of a professional corporation, or if you are employed by a professional corporation subject to significant lay control, we recommend that you determine whether the involvement of unlicensed managers would constitute a violation of the corporate practice of medicine doctrine which could preclude the corporation from enforcing its contracts. Please contact Marvin Kamensky or Stuart Gimbel if you have any questions regarding a corporate medical practice.

KRHD NOTES

Ericka L. Adler has become a partner in the firm. She and **Adrienne Butler** have co-authored two chapters for Illinois Jurisprudence, Volume 27 on Informed Consent in the Healthcare Setting and Medical Malpractice Insurance.

Philip L. Pomerance recently served as a presenter for an AHLA national teleconference on hot topics in healthcare ethics. Mr. Pomerance also serves on the Board of Directors of the American Health Lawyers Association and has been recognized for the second year in a row as one of the ten outstanding physician practice lawyers in America by Nightingale's Healthcare News.

Ben Roth has been reappointed to the Trust Law Legislative Committee of the CBA.

John Waters has become a partner in the firm.

Miles Zaremski and **Alon Stein** have just completed a new chapter on representing the health care provider as personal counsel in professional liability cases for a new IICLE publication. Mr. Zaremski has been invited by the pharmaceutical company, McKesson Corp. in Atlanta, to lecture on health care liability for hospital CEOs in Pebble Beach, CA in February, 2006 and will also have speaking engagements in Las Vegas on behalf of the American College of Legal Medicine, in Honolulu on behalf of the American Bar Association and in Toulouse, France at the World Congress for Medical law.

ESTATE PLANNING: FAMILY LIMITED PARTNERSHIPS

A family limited partnership or limited liability company (LLC) provides a mechanism for families to hold their business and investment assets. These types of entities are often used by parents and grandparents as a vehicle to transfer assets to younger generations during the older generations' lifetimes and at their deaths. The reasons to establish a family limited partnership or LLC to manage family assets as they pass through succeeding generations include the following:

- Provide asset management for family members who need/want it;
- Prevent interests in family property from passing to outsiders as a result of death, divorce or other disposition;
- Protect family assets from individual creditors of a partner;
- Provide access to investment managers with minimum account requirements and potentially obtain reduced fees from investment managers of large accounts;
- Avoid the difficulties associated with ownership of fractional interests of property;
- Control distributions to preserve wealth for the benefit of the family;
- Centralize the management of family assets;
- Facilitate gifts; and
- Provide a vehicle to minimize potential disputes.

Feel free to contact a member of the Firm for more information about setting up family LLCs or limited partnerships.

TAX: NEW ROTH CONTRIBUTIONS TO 401(k) PLANS PROVIDE OPPORTUNITY FOR TAX FREE RETIREMENT INCOME

The IRS has recently issued long-awaited regulations which provide guidance that will enable employers to amend existing 401(k) Plans to permit Roth contributions. Unlike a traditional 401(k) Plan which accepts only pre-tax contributions, a participant in a 401(k) Plan that accepts Roth contributions can elect to designate all or a portion of the participant's elective contribution as a Roth contribution. While the amount designated as a Roth contribution is taxed initially, the earnings on that contribution grow tax-free and generally can be withdrawn tax free at any time after age 59 1/2 (or upon death or disability) so long as the distribution is made at least five years after the first Roth contribution was made to the plan. For individuals who expect to be in a high tax bracket in later years and to have sizable earnings on their investments within their retirement plan, the ability to receive tax-free distributions of those earnings may make these Roth contributions an attractive option.

For more information about establishing a new 401(k) Plan or amending an existing 401(k) Plan to permit Roth contributions, please contact James Shaw in our office.

TAX: ANNUAL GIFTS CONTINUE TO BE ADVANTAGEOUS

In 2006, the maximum amount which each taxpayer is allowed to give each year to as many donees as he or she desires without incurring any gift tax increases from \$11,000 to \$12,000 (or \$24,000 in the case of joint gifts by a husband and wife). If your estate is in the 46% estate tax bracket, a \$12,000 gift will save at least \$5,520 in estate taxes. Since the future increase in the value of the gifted property, as well as the income generated from the gifted property, will be removed from your taxable estate at no gift tax cost, the ultimate estate tax savings will likely be greater than this amount.

In addition to the \$12,000 per donee annual gift exclusion, an individual may gift \$1,000,000 (or \$2,000,000 in the case of a married couple) in the aggregate during his lifetime without incurring a gift tax. The use of discount techniques, such as a family limited partnership, can help to maximize the tax benefits of making gifts.

INFORMATION & ARTICLES IN THIS ISSUE

SUBMITTED BY:

Ericka Adler, Adrienne Butler, Stuart Gimbel,
David Hochman, James Shaw, John Waters.

NEWSLETTER COORDINATORS:

Lauren Hernandez and Sandra Weisenberg

TAX: IRS ANNOUNCES THAT "USE IT OR LOSE IT" CAFETERIA PLAN RULE MAY BE MODIFIED

The IRS has announced that employers may elect to modify their cafeteria plan's (also known as flexible benefit plans) "use it or lose it" rule to allow participants to use any balance remaining at the end of the plan year within a 2 ½ month post-year grace period.

Cafeteria plans allow employees to pay for qualified benefits with pre-tax dollars. These benefits include employer-provided accident and health plans excludable under Internal Revenue Code Sec. 106 and 105(b), group term life insurance excludable under Code Sec. 79, dependent care assistance programs excludable under Code Sec. 129, and adoption assistance programs excluded under Code Sec. 137. A cafeteria plan cannot defer the receipt of compensation or operate in such a way as to allow participants to defer compensation by, for example, allowing participants to use contributions from one plan year to buy a benefit that will be provided in a subsequent year. This is referred to as the "use it or lose it" rule, requiring that unused contributions remaining at the end of a plan year are lost.

IRS Notice 2005-42 permits, but does not require, an employer to amend its cafeteria plan to give all participants a grace period of up to 2 ½ months immediately following the end of the plan year, during which period expenses for benefits incurred during the grace period could be reimbursed from benefits or contributions remaining unused. If such an amendment is made, a participant who has unused benefits or contributions relating to a particular qualified benefit from the immediately preceding plan year, and who incurs expenses for that same benefit during the grace period, may be reimbursed for those expenses from the unused contributions as if the expenses had been incurred during the plan year.

The net effect is that a participant could have as long as 14 months and 15 days to use the benefits or contributions for a plan year before those amounts are forfeited. However, unused benefits or contributions cannot be converted to any other benefit. For example, unused amounts in a healthcare flexible spending arrangement ("FSA") could not be used to pay or reimburse dependent care or other expenses during the grace period. Example: ABC Corp.'s cafeteria plan ends on December 31, 2005. ABC amends the plan before the end of 2005 to allow for a grace period, which will end on March 15, 2006. Employee elected a salary reduction of \$1,000 for his healthcare FSA for the year ending in 2005, and \$1,500 for the year ending in 2006. As of Dec. 31, 2005, Employee has \$200 remaining in his FSA. During the grace period, Employee incurs \$300 of unreimbursed medical expenses. The unused \$200 from 2005 may be used to pay for \$200 of these expenses and \$100 from the plan ending in Dec. 31, 2006 may be used to pay for the \$100 of expenses remaining. Therefore, on March 16, 2006, Employee has \$1,400 remaining in his FSA for the 2006 plan year.

Larger employers may not want to take advantage of this rule for the following reasons:

1. It might be difficult to undo the amendment once adopted, from an employee point of view.

2. There may be administrative issues with the 2 ½ month overlap. In addition, because the IRS did not modify the period during which employee elections can be made, participants using last year's money for the first 2 ½ months of the current plan year will be less likely to utilize that year's election amount.

3. Many employers have some money left over to offset plan expenses. Adding additional time will likely lessen the amount of money available for this purpose.

4. Employers may have to pay their vendor extra fees during the grace period, because the vendor will be administering two different plan years during that 2 ½ month overlap.

If, despite these potential disadvantages, you decide that you want to modify your cafeteria plan for the current year, you must amend your plan document before year's end.

PENSION: CONTRIBUTE MORE IN 2006

The IRS has announced the following cost of living adjustments for retirement plans:

	2005	2006
Maximum Compensation Limit	\$210,000	\$220,000
Maximum Annual Addition Dollar Limit	\$42,000	\$44,000
Maximum Annual Addition Percentage of Compensation Cap	100% of Pay	100% of Pay
Maximum 401(k) Contribution Dollar Limit	\$14,000	\$15,000
Maximum 401(k) "Catchup" Contribution*	\$4,000	\$5,000
Social Security Taxable Wage Base	\$90,000	\$94,200
Maximum Percentage for Permitted Disparity	5.7%	5.7%
Defined Benefit Plan Maximum Annual Benefit	\$170,000	\$175,000

*Plan Participants who are 50 or older in 2006 who make the maximum 401(k) contribution may also make a 401(k) "catchup" contribution of \$5,000 in calendar year 2006. The "catchup" contribution does not count as part of the maximum annual addition limit. Accordingly, in calendar year 2006, a participant in a 401(k) profit-sharing plan can make a 401(k) contribution of \$15,000, a 401(k) catchup contribution of \$5,000 and also receive employer contributions of up to \$29,000 for a total of \$49,000.

HEALTHCARE: CMS ADDS NUCLEAR IMAGING AND PET SCANS TO LIST OF DHS

In the 2006 Physician Fee Schedule, published in the Federal Register on August 8, 2005, CMS proposed including PET scans and diagnostic nuclear imaging as part of the Stark definition of "radiology and certain other imaging services." As a result, these services will be included as Stark designated health services ("DHS"). This means that entities cannot bill Medicare for PET scans or nuclear imaging tests if the tests are performed on patients referred by physicians having a financial interest in the DHS entity unless a Stark exception applies. Physicians who are involved in PET scan and nuclear imaging ventures must either unwind such ventures or restructure them. Medicare has since indicated that nuclear medicine will not become a DHS until January, 2007. No update on PET has been provided.

In the same regulation, CMS cut payments for imaging performed in physician offices and freestanding radiology centers. When two different radiology services are performed on the same patient on the same date of service, Medicare proposes to pay 100% of the technical fee for the first test (for example, an MRI of the entire abdomen) but only 50% of the technical fee for the second test (the MRI of the abdomen may prompt a physician to order an MRI of the pelvis). However, Medicare will continue to pay full price for the professional reading of both images.

Under current law, there are ways for physicians to comply with these new bans by restructuring their current arrangements. Interested clients should contact Ericka Adler or Dorothy Ward to discuss available options.

HEALTHCARE: MEDICAL LITIGATION REFORM BILL PASSES LEGISLATURE

On August 26, 2005, Governor Blagojevich signed S.B. 475, the medical tort reform bill that will limit the amount a jury can award a plaintiff for personal pain and suffering to \$500,000 from physicians and \$1,000,000 for hospital judgments.

Key provisions of the bill include:

Institution of a \$500,000 cap on non-economic damage awards for physicians and \$1,000,000 awards for hospitals. There will be no exceptions and no indexing for inflation.

The affidavit of merit will require disclosure of the consulting physician's name and the physician must be an expert in the same, or substantially similar, area of medicine that is the subject of the lawsuit.

Expert witnesses must be board certified or board eligible in the same specialty as the defendant physician. The expert must devote a majority of time to the practice of medicine, teaching or research. Retired experts must keep current with continuing medical education.

Physicians who offer free home visits or free care in free medical clinics will receive good faith immunity.

Statements of grief or apology from physicians cannot be used in court if made within 72 hours after discovery of a bad outcome or error.

Resources of the state Medical Disciplinary Board and the Illinois Department of Financial and Professional Regulation ("IDFPR") will be expanded.

Profiles of physicians' professional credentials, including 5-year disciplinary and medical litigation history, will be available on the internet.

The Illinois Department of Insurance will have more power to call hearings to determine whether rates are excessive or inadequate.

S.B. 475 makes it possible, for the first time ever, for the state to deny medical malpractice rate increases. The IDFPR will collect and make available actuarial data relied upon for pricing by every malpractice carrier. If an insurer files a request for rate increases of more than six percent (6%), public hearings on the proposed increase will be mandatory. For lesser increases, such hearings will be at the discretion of the IDFPR.

The bill became effective immediately upon signing. It is hoped by legislators that the legislation will reduce frivolous suits, better enable the state to control malpractice insurance costs and reduce the incidence of malpractice by more effectively disciplining physicians when it is indicated.

EMPLOYMENT LAW: FIVE YEAR, FIVE MILE RESTRICTIVE COVENANT NOT UNREASONABLE

In the recent case of Mohanty v. St. John Heart Clinic, S.C., (Ill. App. 1 Dist. 2005), the Illinois appellate court examined a suit brought by two employed physicians who signed contracts with a restrictive covenant prohibiting them from working within a five (5) mile radius of their employer's clinic in "any office established for the practice of medicine." One of the contracts placed restriction on the physician for five (5) years after termination of the agreement, while the other was for three (3) years.

The physicians alleged a breach of their employment agreements by the employer and the employer counter-sued alleging the physicians had violated the terms of their restrictive covenants. In an action to enforce the covenants against the physicians through a preliminary injunction, the trial court denied the employer's motion. Upon review of restrictive covenants by the appellate court for time and geographic restrictions, and for the effect on the physicians' activities, the court found that the time restrictions were reasonable and, because the area at issue was a heavy populated Chicago Metropolitan area, neither the time restrictions nor the five (5) mile limitation would deprive the physicians of employment. In addition, the court found that the language of the restrictive covenant which prohibited the "practice of medicine in its entirety", was not unreasonable because the employer testified that he saw patients with non-cardiology problems and made referrals and thus the Court held that allowing the employed physicians to practice other types of medicine within the bounds of the geographic restriction could place them in competition with their former employer.

This case provides some additional clarification on how the Illinois appellate courts are enforcing restrictive covenants in Illinois. Please contact Stuart Gimbel if you have questions about your restrictive covenant.