November 2, 1993

John E. Steiner, Jr., Esquire

Assistant General Counsel

American Hospital Association

840 North Lake Shore Drive

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Dear John:

I am responding to your letter of July 20, 1993, requesting assistance in interpreting the scope of prohibited referrals under the Medicare and Medicaid anti-kickback statute with respect to the acquisition of physician practices. The focus of your inquiry was the position taken in my December 22, 1992 letter to T. J. Sullivan at the Internal Revenue Service that payments for intangible assets or goodwill were open to question under the anti-kickback statute, and my subsequent oral comments on this issue.

In particular, in your letter you presented two specific situations involving the acquisition of a physician's practice. The first situation involved the purchase of a physician practice by another physician or a group practice. I have assumed the acquiring practice is not in a position to benefit from referrals by the acquired practice. After reaching agreement on the price for the hard assets, the parties proceed to value the remainder of the practice and assign a value for the expectation of future patronage by patients to the practice being acquired. The total price negotiated for the practice includes an amount for both the hard assets and the intangible assets. You described this situation as involving a "one-step" referral, a situation where the patients "self-refer" because of word of mouth about the physician or because another unrelated physician refers to the practice.

The second situation involves the acquisition of the same or a similar physician practice, except that the purchaser is a hospital, which is in a position to benefit from referrals by the acquired practice. The same valuation method is used to determine the purchase price. Even though the hospital can be expected to receive admissions and referrals from the practice, the value of these referrals are not used in the valuation of the practice. Only the expected future patronage to the practice is included and the hospital does not pay more for the practice than would another physician. This situation is described as involving a "two-step" referral process, one to the practice and a second one to the hospital.

You sought an opinion clarifying whether the payments made in either or both of these situations would be allowable under the anti-kickback statute. As you know, the Medicare and Medicaid anti-kickback statute, section 1128B(b) of the Social Security Act, 42 U.S.C. 1320a-7b(b), makes it a criminal offense to knowingly and willfully offer, pay, solicit, or receive remuneration to induce, or in return for, the referral of business covered by Medicare or Medicaid.

For a number of reasons, we are not in a position to issue advisory or interpretive opinions on whether a particular practice or arrangement violates the anti-kickback statute. One reason is that since section 1128B(b) is a criminal statute, the Department of Justice has exclusive authority to initiate a criminal prosecution or decline to do so under the statute. Another reason is that the statute requires proof of knowing and willful intent, and it is generally impossible to evaluate intent on the basis of a paper submission. Finally, in reviewing a particular arrangement, we cannot be sure that we have all the necessary information concerning the nature of the arrangement or practice and how it operates in order to make a proper decision concerning its legality or illegality.

I would like to emphasize that the position I articulated in the December 22, 1992 letter to T. J. Sullivan remains the same. I did not state that payments for intangible assets are illegal per se. Nor have I indicated approval of any particular acquisition practices or valuation methodologies. Since payments for items other than the hard assets of a physician practice could be a payment to induce referrals or could be in return for future referrals, any such payments are subject to scrutiny to determine whether they violate the anti-kickback statute. The fact that the parties may identify the purpose of the payment as something other than a payment for referrals is not determinative.

Similarly, the fact that two different parties may offer to pay the same price for a particular or a comparable physician practice or may use a similar approach in "valuing" the practice does not mean that both will be afforded the same treatment under the anti-kickback statute. The intent of the parties is the critical element in the determination of a violation under the anti-kickback statute, and different parties may have different purposes and reasons for seeking to acquire a particular physician practice and for paying a particular price. Finally, the facts and circumstances involved in each situation are likely to be different as will be the nature of the relationship between the parties. Consequently, each particular situation must be judged on its own merits and based on its own facts and circumstances.

Turning to the two situations described above, we believe the first situation is far less problematic than the second. However, either situation could constitute a violation of the anti-kickback statute, depending on the intent of the parties, the nature of the intangible assets, the amounts paid for the intangible assets, and the past and future relationship of the parties, etc. One major factor is where the seller becomes or remains affiliated with the buyer. In such a case, the terms of that continued affiliation as well as the remuneration paid to the seller for services rendered would also need to be taken into account in determining whether a violation exists.

With respect to the second situation involving the purchase of the practice by a hospital, anytime an entity is acquiring a practice where the entity is in a position to benefit from referrals from the practice, there is always a question that a portion of the amount paid for the practice is attributable to the future referrals. As indicated above, it is the intent of the parties and the facts and circumstances of the particular acquisition that are relevant. Accordingly, the fact that a hospital purchases a physician practice for the same amount that another physician might pay does not insulate the hospital from liability under the anti-kickback statute. For example, another physician may offer a high price based on the savings in administrative costs and overhead which could be realized by combining practices. However, a hospital may not have that

motivation at all; its offer of the sameprice could be motivated by a desire to pay for future referrals.

We hope this information is helpful and regret that we are unable to provide further guidance. Thank you for your interest in this matter.

Sincerely,

/s/

D. McCarty Thornton

Associate General Counsel

Inspector General Division