

## Related Party Transactions and CMS's Role in Regulation

### What are related parties?

In 2003, an article published in the Journal of Health Law suggested that nursing homes should undergo corporate restructuring to help avoid civil liability for negligent care.<sup>1</sup> The article suggested that by creating separate, single-purpose corporations, owners and operators could protect assets that would otherwise be subject to civil judgment. The article's chief recommendation was that owners separate the operational side of the nursing home from the real estate side. The article stated:

"There is an emphasis on separating the ownership of the real estate from the ownership of the operating entity that holds the license and Medicare and Medicaid provider agreements. This is normally achieved by having the operating entity lease the facility from the real property entity. This can be accomplished even where there is identical ownership and control between and among the real-property entity and the operating entity."

Not mentioned in the article was an additional benefit to owners: they could use the corporation that owned the real estate (which they own) to charge unrestricted rent and lease fees to the nursing home (which they also own). Essentially, owners began charging themselves to rent their own facility through related party transactions.

Since the publication of this article, this practice has proliferated, with some estimating that 75% of nursing homes engage in related party transactions.<sup>2</sup> However, the practice has evolved to include not only real estate but almost every aspect of nursing home operations. It is now common for nursing homes to have several related party organizations with which they do business, for instance, management companies, physical therapy companies, staffing companies, and others. This practice can often translate into millions of dollars in payments by a single nursing home to companies that are in fact owned by the owners of the facility. For instance, Life Care, a nursing home chain with over 200 nursing homes and 25,000 beds, in 2018 reported over 260 separate related party expenses on its Medicare cost reports. These related parties include management companies, staffing companies, insurance companies, therapy companies and many more. Over the three-year period from 2018 to 2020, Life Care reported \$1.25 billion dollars in payments to related parties (to themselves).<sup>3</sup>

Critically, related parties can serve to mask profits. On Medicare cost reports related party transactions show up as expenses. There has been little to no scrutiny on the amount facilities pay related parties. When high amounts are paid to the related party, the nursing home looks much less profitable, even though they are paying the nursing home owners themselves. As a result, nursing homes can assert that their facilities are not making a profit, or are even losing money, when high amounts are being paid to related party companies.

## How are related party transactions reported?

CMS requires facilities to report payments to related parties. 42 C.F.R. § 413.7<sup>4</sup> defines related parties and requires facilities to annually report on Medicare cost reports how much a facility has paid to a related party. Each year, nursing homes receiving Medicare payments must submit a cost report. 42 C.F.R. § 413.20(b). The information included in cost reports include, (1) provider ownership, (2) fiscal, medical and other recordkeeping systems, (3) federal income taxes, (4) assets, (5) management arrangements, (6) patient fee schedules, (7) operational costs, (8) income by source and purpose, and (9) flow of funds. See § 413.20(d)(2). All this information is submitted electronically, on CMS form 2540-10.

Additionally, nursing homes are required to report all transactions with related party companies. These transactions are broken down into costs that are allowed (reimbursable) under the Medicare program and the actual payment made to the related party. The payments, in some instances, exceed the allowable cost by over 1200%. Nevertheless, despite some of these payments exceeding the Medicare allowed costs, it is not apparent that CMS is auditing these costs, nor does it appear that they are requiring nursing homes to reimburse the federal government for these excess payments.

## CMS's authority to regulate related party transactions

The Nursing Home Reform Act of 1987 states:

“It is the duty and responsibility of the Secretary of Health and Human Services]to assure that requirements which govern the provision of care in skilled nursing facilities under this subchapter, and the enforcement of such requirements, are adequate to protect the health, safety, welfare, and rights of residents and to **promote the effective and efficient use of public moneys.**” (Emphasis Added) (42 U.S.C. § 1395(f)(1).

The Secretary is provided broad regulatory authority to ensure that Medicare and Medicaid dollars are spent appropriately. Additionally, the Medicare Provider Reimbursement Manual provides in-depth guidance as to how related parties must be reported. CMS requires nursing home providers to be “prudent buyers”- meaning they must actively seek to minimize costs by ordering in bulk, negotiating with suppliers, and obtaining multiple quotes for goods or services.<sup>5</sup> In other words, owners must not inflate costs paid to related parties but pay only what they would if they purchased the goods or services on the open market.

Importantly, the manual requires related parties, when requested, to provide “adequate documentation to support the costs incurred by the related organization, **including, when required, access to the related organization’s books and records, attributable to supplies and services to the provider.**”<sup>6</sup> (emphasis added). It is unclear if CMS requests this information or conducts audits of these books and records.

In line with its authority and to achieve increased disclosure, CMS should:

- Require nursing homes to submit consolidated cost reports, which would require owners and operators to report financial information on all companies related to the operation of the nursing homes, including related parties, holding companies, shell corporations, and other entities nursing homes use to mask ownership and profit-taking. Importantly, this disclosure would have to occur back to the ultimate owners of the nursing home. CMS should require these reports to be audited by a certified public accountant prior to submission.
- Routinely, through manual and automated processes, review, and audit cost reports.
- Require increased disclosure requirements for related parties to determine whether costs charged to nursing homes for goods and services are reasonable and prudent.
- Make information on cost reports more easily accessible to consumers.
- Conduct targeted surveys of nursing homes with unreasonable and excessive related party transactions to protect residents from poor care.

Increased transparency and accountability in nursing home cost reporting would shine a light on how nursing home owners and operators spend taxpayer dollars and would better ensure that the money is used for resident care and safety.



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<sup>1</sup> Casson JE, McMillen J. Protecting nursing home companies: limiting liability through corporate restructuring. *J Health Law.* 2003 Fall;36(4):577-613. PMID: 15068276

<sup>2</sup> "These Administrative Actions Would Improve Nursing Home Ownership and Financial Transparency In The Post COVID-19 Period", *Health Affairs Blog*, February 11, 2021. DOI: 10.1377/hblog20210208.597573.

<sup>3</sup> Please see our in-depth report, "Where Do the Billions of Dollars Go: A Look at Nursing Home Related Party Transactions," in which we analyze the cost reports from three major nursing home chains in the United States.

<https://theconsumervoice.org/uploads/files/issues/2023-Related-Party-Report.pdf>

<sup>4</sup> § 413.17 **Cost to related organizations.**

**(a) Principle.** Except as provided in [paragraph \(d\)](#) of this section, [costs](#) applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are includable in the allowable [cost](#) of the provider at the [cost](#) to the related organization. However, such [cost](#) must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere. **(b) Definitions –**

**(1) Related to the provider.** Related to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities, or supplies.

**(2) Common ownership.** Common ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider.

**(3) Control.** Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution.

<sup>5</sup> CMS requires nursing home providers to be "prudent buyers"-meaning they must actively seek to minimize costs by ordering in bulk, negotiating with suppliers, and obtaining multiple quotes for goods or services.). If a nursing home is found to have excessive costs beyond what a prudent buyer would pay, absent a "clear justification" for the excess, CMS should not reimburse these costs. *Ctrs. for Medicare & Medicaid Servs., U.S. Dep't. of Health & Hum. Servs., Program Manuals §2103 (Rev. 454).*

<sup>6</sup> *Ctrs. for Medicare & Medicaid Servs., U.S. Dep't. of Health & Hum. Servs., Program Manuals § 1005 (Rev. 386).*