

## Section 1202: What Exactly Are ‘Health’ Services?

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In this article, the authors examine a range of health-related businesses and outline key factors affecting whether they qualify as businesses performing services in the field of health for purposes of section 1202.

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### I. Introduction

Recent years have seen a proliferation of interest in section 1202, which has become a critical driver of many private equity and venture capital investments. Section 1202 provides a 100

percent exclusion from capital gain on the sale of stock of a qualified small business (QSBS) that has been held for five years.<sup>1</sup> One of the many requirements of section 1202 is that the small business corporation must constitute a qualified trade or business (QTOB), which includes all businesses other than certain businesses explicitly excluded.<sup>2</sup> One of those excluded businesses is a business performing services in the field of “health.”<sup>3</sup>

The term “health” is not defined in the section 1202 text, legislative history, or related regulations.<sup>4</sup> Because numerous companies in today's business climate provide services in the ever-expanding healthcare field, tax advisers are frequently asked whether a particular healthcare-related business qualifies as a QTOB.<sup>5</sup>

Many businesses commonly viewed as part of the healthcare industry likely fall outside the definition of health services businesses under section 1202. Although U.S. government websites suggest that around 20 million people are employed in the U.S. healthcare sector,<sup>6</sup> “services

<sup>1</sup> For a summary of the requirements of section 1202, see Joseph Wiener and Stefan Gottschalk, “Travels Through 1202,” *Tax Notes Federal*, Sept. 27, 2021, p. 2083; Paul S. Lee et al., “Qualified Small Business Stock: Quest for Quantum Exclusions,” *Tax Notes Federal*, July 6, 2020, p. 15.

<sup>2</sup> Section 1202(e)(3).

<sup>3</sup> Section 1202(e)(3)(a).

<sup>4</sup> Section 1202 suffers from numerous definitional ambiguities. The IRS has included section 1202 on its 2023-2024 and 2024-2025 priority guidance plans. IRS officials said several years ago that the agency was considering issuing guidance on the meaning of the QTOB terms. See Kristen Parillo, “IRS Aiming to Fill Guidance Gap on Capital Gain Exclusion,” *Tax Notes Federal*, Nov. 15, 2021, p. 984 (noting the dearth of guidance on section 1202).

<sup>5</sup> Section 199A, enacted in 2017, contains a list of businesses similar to the list in section 1202. Regulations issued several years ago to interpret section 199A's terms shed light on some of the questions we raise in this article. See reg. section 1.199A-5(b)(2)(ii). However, as we discuss later, those regulations explicitly state that they apply solely for purposes of section 199A and do not govern for purposes of applying other sections of the code. Reg. section 1.199A-5(b)(2)(i)(A).

<sup>6</sup> See, e.g., U.S. Centers for Disease Control and Prevention, “About Healthcare Workers” (Sept. 24, 2024).

in the field of . . . health” likely refers to a narrower subset within that broad category. However, in many cases, the answer is less than clear.

For example, one might ask whether the following businesses perform services in the field of health:

- a company that provides healthcare administration services;<sup>7</sup>
- a clinical laboratory that conducts bloodwork on behalf of patients or on behalf of hospitals; or
- a counseling service, a social work practice, or a life coach practice (a psychology practice provides services in the field of mental health, which probably constitutes a subcategory of “health”).

This article surveys a range of health-related businesses, reviews IRS and judicial interpretations of the term “health” outside section 1202, and outlines key factors affecting qualification. Our review suggests that some business types likely fall outside the scope of health services, some fall within, and many others fall in a gray area.

## II. Healthcare-Related Businesses — Qualifying?

Many millions of professionals in the United States work in the healthcare industry.<sup>8</sup> Many of the services they provide do not squarely involve health services. These can be grouped into several general categories.

### A. Administrative Services

Because of the complexity of medical insurance billing, numerous businesses have been organized solely to handle healthcare-related administrative services. Typically, these companies are not staffed by doctors or nurses, a

factor that cuts against classifying these services as services in the field of health.

What about a company partially staffed by medical practitioners? For example, suppose a company partially staffed by doctors advises insurance companies on whether to approve various procedures, or advises a provider on whether a procedure is covered under a patient’s insurance.

Suppose a company provides individualized healthcare support and advocacy to help patients navigate the complicated healthcare system (patient navigation or advocacy). The company assists with medical referrals, doctor selection, patient advocacy, and general hand-holding (all of which may be nonhealth services). But the company also employs nurses to assist the patient with medical decision-making. Is this company engaged in the performance of services in the field of health?

### B. Pharmaceutical/Drug/Laboratory

Numerous businesses manufacture and produce pharmaceutical drugs and medical devices. Do these businesses provide services in the field of health? If the distinction turns on providing a product rather than a service, what about laboratories that take blood from patients, perform laboratory tests, and provide the results to the patient’s doctor? If such a laboratory’s service is in the field of health, is a laboratory that services hospitals any different? It does not interact with patients but merely receives bloodwork from hospitals, performs the laboratory testing, and provides a report to the hospital.<sup>9</sup>

What about a neighborhood pharmacy — is it engaged in the performance of a service in the field of health, especially if it provides nothing other than prescription drugs to patients?<sup>10</sup> Does it matter whether its pharmacists spend significant amounts of time advising patients on health issues? What if, aside from selling prescription

<sup>7</sup> The code’s language “any trade or business involving the performance of services in the fields of health” is perhaps more restrictive than if the phrase “the performance of services in” had not been included. Because the *services*, and not merely the *business*, must be in the field of health, a company that sits squarely within the healthcare sphere but whose services do not consist of health services often can qualify as a QTOB. An example is a company that provides pure administrative support services to a medical practice. (See further in this article for a discussion regarding companies that provide such administrative services.)

<sup>8</sup> See, e.g., Earlene K.P. Dowell, “Health Care Still Largest U.S. Employer,” U.S. Census Bureau (Oct. 14, 2020).

<sup>9</sup> See Section III.C, *infra*, in which we discuss some IRS letter rulings concerning these business types.

<sup>10</sup> Most neighborhood pharmacies derive a substantial portion of their revenue from sales of over-the-counter medication and ancillary products; those sales clearly do not constitute services in the field of health.

drugs, the pharmacy also performs flu tests, COVID-19 tests, and other diagnostic tests on behalf of patients?

### C. Nondiagnostic Assessments

Suppose a business is formed to service the life insurance industry — life insurance companies hire the business to conduct physical exams of their customers before issuing an insurance policy. The business sends a representative to the customer's home; the representative performs a health assessment and takes blood. The business then provides its health assessment of the customer to the life insurance company. Is it performing a service in the field of health? (And does it matter whether the business performs a holistic assessment of the customer's health or merely provides raw data to the insurance company?)

Similarly, suppose a business is formed to provide preemployment physical exams. Fire departments, police departments, and companies employing manual laborers hire the business to perform physical assessments to ensure that their employees or potential employees are fit for the job. The physical exam often includes taking pulse, blood pressure, and other vital signs. Aside from providing raw data, the company might provide an assessment of the employee's overall health to the employer following the exam. Is this a service in the field of health?

### D. Personal Fitness and Exercise

Is a business that helps patients with personal fitness performing a service in the field of health? How about a health club or health spa?<sup>11</sup> A company that provides personal training? All these businesses serve to improve the health of their customers.

What about an athletic training business? The company hires athletic trainers who assist sports teams and athletes by developing personalized health plans, physical therapy plans, and fitness

goals. The trainers also examine and treat injuries and medical conditions.

Is a nutrition and diet clinic providing services in the field of health? The clinic employs nutritionists and dietitians to help patients seeking healthier living.

### E. Mental Health

A psychology practice provides services in the field of health, because mental health is a subcategory of health. What about a social work practice? A professional counseling practice? A life coach practice?

Does the focus of the practice matter? For example, one counseling practice might specialize in anxiety, a second in marriage counseling, a third in executive functioning, and a fourth in child behavior issues. The same practice will often have several specialties.

What about the provision of alternative therapy, such as hypnotherapy? Might it depend on the purpose of the therapy? Might it depend on whether the service is covered by standard health insurance policies?

### F. Other Health-Related Services

There are various other services that are related to health but are not typical healthcare services. They are often not covered under health insurance plans. Examples include:

- infertility testing and treatment;
- genetic testing for couples' compatibility;
- hair loss treatment;
- orthotics, shoe fitting, and prosthetics services;
- alternative medicine, such as acupuncture and homeopathy; and
- veterinary services.

Do those constitute services in the field of health?

### G. Part Housing, Part Medical

Some businesses provide a mix of housing and healthcare services. One example is a nursing home business. The degree of medical services provided by a nursing home facility can vary. Some facilities outsource the medical services to a local healthcare company, to which it pays a fee, while others do not.

<sup>11</sup> In Section III, *infra*, we discuss regulations issued under sections 448 and 199A that state that a health spa does not constitute health services. A related and more recent business type is a medical spa, which combines the elements of a traditional spa with medical-grade aesthetic treatments, such as Botox, often under the supervision of a licensed physician. These additional features may affect the section 1202 analysis.

Another example of this business type is an outpatient surgical center that does not perform surgical procedures but outsources all healthcare services, including the surgery itself, to a separate healthcare company. Are these in the field of health?<sup>12</sup>

A similar question can be raised about an ambulance company or a company that provides emergency plane services. Do these companies provide healthcare services, or do they primarily provide transportation services? And does the answer change if the company outsources the healthcare component to a separate healthcare company?

## H. Health-Tech Services and Tools

Aside from these categories and examples, further questions will arise as the healthcare industry evolves. During the past several years, and spurred by the COVID-19 pandemic, there has been a proliferation of companies providing healthcare-type services through telemedicine and new technological devices. Companies offering these services and products may need to determine whether they are engaged in health services for purposes of section 1202.

## III. Guidance

In the absence of statutory or regulatory guidance, dictionary definitions are sometimes helpful. However, dictionary definitions of health do not provide clear answers.<sup>13</sup> Moreover, the term used in section 1202, “field of health,” seems to have a slightly different meaning than the mere term “health.”

Although tax guidance in this area is relatively scarce, taxpayers can look to three general sources: (1) regulations and court decisions under section 448; (2) regulations under section 199A; and (3) letter rulings under section 1202.

<sup>12</sup>In Section III.B, *infra*, we discuss regulations issued under section 199A, including an example of a surgical center.

<sup>13</sup>Merriam-Webster’s most relevant definition of health is “the general condition of the body.” Oxford Dictionary defines health as “the condition of a person’s body or mind.” These definitions are expansive and vague.

## A. Section 448

Section 448 provides that a corporation may not use the cash method of accounting unless an exception applies, one of which is that it qualifies as a personal service corporation. A personal service corporation is a corporation that performs services in certain fields, one of which is health.<sup>14</sup> Temporary regulations under section 448, issued in 1987, provide some insight into the meaning of the term “performance of services in the field of health”:

The performance of services in the field of health means the provision of medical services by physicians, nurses, dentists, and other similar healthcare professionals. The performance of services in the field of health does not include the provision of services not directly related to a medical field, even though the services may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers.<sup>15</sup>

It appears appropriate to use the temporary section 448 regulations as a source of guidance. The section 1202 list of excluded businesses includes all the businesses listed in section 448(d)(2)(A).<sup>16</sup> Accordingly, it stands to reason that the section 448 regulatory and judicial interpretation of health can be used to interpret the term as used in section 1202.

<sup>14</sup>Section 448(d)(2)(A).

<sup>15</sup>Reg. section 1.448-1T(e)(4)(iv). Under section 7805(e)(2), enacted in 1988, temporary regulations are binding for only three years. However, because section 7805(e)(2) does not apply retroactively, it generally effectively grandfathered in all temporary regulations issued before its enactment. See Technical and Miscellaneous Revenue Act of 1988, section 6232(b) (applying the three-year expiration date only to regulations issued after the enactment of section 7805(e)(2)). The section 448 regulations were issued in 1987, before the enactment of section 7805(e)(2).

<sup>16</sup>Moreover, the preamble to the section 199A proposed regulations says that “the text of section 1202(e)(3)(A) substantially tracks the definition of ‘qualified personal service corporation’ under section 448.” Preamble to REG-107892-18, 83 F.R. 40884, 40896 (Aug. 16, 2018).



For purposes of section 448, courts and the IRS have concluded that the following are services in the field of health: veterinary services,<sup>17</sup> physical therapy services,<sup>18</sup> emergency medical ambulance technician services,<sup>19</sup> radiation technician services,<sup>20</sup> and sonography services.<sup>21</sup>

## B. Regulations Under Section 199A

Section 199A, enacted as part of the Tax Cuts and Jobs Act, permits certain taxpayers to deduct up to 20 percent of certain types of business income. However, section 199A provides that income from many of the services listed in section 1202 is excluded from the section 199A benefit.<sup>22</sup> One of the excluded services that carries over from section 1202 to section 199A is “health.”

Although the section 199A provision does not offer guidance on the meaning of health, the section 199A regulations provide some guidance:

For purposes of [section 199A] only, the performance of services in the field of health means the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals performing services in their capacity as such.<sup>23</sup>

However, the regulations say:

The performance of services in the field of health does not include the provision of services not directly related to a medical

services field, even though the services provided may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or the research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.<sup>24</sup>

The section 199A regulations also provide four examples illustrating the meaning of services in the field of health<sup>25</sup>:

- The first example involves a pharmacist who performs services such as receiving orders from physicians, making recommendations on dosing to the ordering physician, performing inoculations, checking for drug interactions, and filling pharmaceutical orders for patients receiving care. The pharmacist is treated as engaged in the performance of services in the field of health.
- The second example involves a residential facility that provides services to older adults who live on the campus. Although the facility contracts with health providers to perform medical procedures at the residential facility, the facility is treated as not engaged in the performance of services in the field of health because the health providers bill the clients directly.
- The third example involves a specialty surgical center that provides outpatient medical procedures that do not require the patient to remain overnight for recovery. It does not employ physicians, nurses, or medical assistants but enters into agreements with others to perform the procedures. Patients are billed by the center for the facility costs and by the healthcare professional for the costs of the procedure conducted by the physician and medical support team. The center is treated as not engaged in the performance of services in

<sup>17</sup> Rev. Rul. 91-30, 1991-1 C.B. 61.

<sup>18</sup> LTR 9222004 (a physical therapy practice is engaged in health services even though it does not diagnose; the practice’s “inability to prescribe medicine does not immunize it” from being treated as a health service profession).

<sup>19</sup> LTR 9309004 (“Technicians are licensed and certified pursuant to the state health and safety code and must pass a statewide competency test. . . . The very nature of a Technician’s services are similar to the services provided by other health-care professionals such as physicians and nurses.”).

<sup>20</sup> *W.W. Eure M.D. Inc. v. Commissioner*, T.C. Memo. 2007-124 (the court explained that the employees have advanced training, and the time they spend maintaining the radiation equipment is incidental to the healthcare services).

<sup>21</sup> *Zia-Ahmadi v. Commissioner*, T.C. Summ. Op. 2017-39 (the court explained that sonographers are more similar to physicians and nurses than to employees of health clubs or health spas).

<sup>22</sup> Section 199A(b) and (d).

<sup>23</sup> Reg. section 1.199A-5(b)(2)(ii).

<sup>24</sup> *Id.*

<sup>25</sup> Reg. section 1.199A-5(b)(3).

the field of health for reasons similar to those in the prior example.

- The fourth example involves the developer of a test used to detect a medical condition. The developer (which employs only a single employee with an advanced medical degree; all other employees are technical support staff) accepts test orders only from healthcare professionals; has no contact with patients; and does not diagnose, treat, or manage any aspect of patient care. The developer is treated as not engaged in the performance of services in the field of health.<sup>26</sup>

Although the section 199A regulations and examples are helpful, their use is limited for purposes of our inquiry. Those regulations state explicitly that their explanation of the meaning of the QTOB terms applies solely for purposes of section 199A.<sup>27</sup> Accordingly, the section 199A regulations are not authoritative guidance for taxpayers when interpreting section 1202.

### C. Section 1202 Letter Rulings

During the past decade, the IRS has issued several letter rulings on the meaning of health for purposes of section 1202, addressing a pharmaceutical company, a medical testing company, a health product manufacturer, a healthcare-related software development

company, a mail-order retail pharmacy, and a medical testing company.

LTR 201436001 involves a company that works with clients in the pharmaceutical industry to help commercialize experimental drugs. The company's activities include research and development, precommercial testing, and the manufacture of drugs. Despite the company's proximity to the field of health, the IRS ruled that its services did not fall within the category of health.

LTR 201717010 addresses a company that used proprietary technologies to detect the incidence of a particular health issue. The company held a patent on the medical test, which it used to test patients, and the company would relay the results of the test to the patient's doctor. Because the company did not diagnose, provide treatment, or interact with the patient, the IRS ruled that it was not involved in the field of health.

In LTR 202125004, the IRS ruled that a manufacturer of healthcare products prescribed by healthcare providers was not engaged in health services within the meaning of section 1202(e)(3). This determination was based largely on the fact that the business provided value to its customers primarily in the form of tangible products, not services.

In LTR 202144026, the IRS determined that a company that developed software intended to aid healthcare professionals and patients in making medical treatment more effective was not a business engaged in health services within the meaning of section 1202(e)(3). The IRS appeared to base its ruling on the fact that the software did not diagnose or recommend treatment, and the company did not provide value in the form of individual expertise.

In LTR 202221006, the IRS ruled that a corporation involved in the mail-order retail sale of a limited number of pharmaceutical drugs was not a business engaged in health services within the meaning of section 1202(e)(3). The IRS reasoned that since the employees did not diagnose or recommend treatment but merely filled prescriptions and processed insurance payments, the business was not engaged in the performance of services in the field of health (even though the pharmacists interacted with patients who had questions about their prescriptions).

<sup>26</sup> Also, the preamble to reg. section 1.199A-5 (T.D. 9847) contains several interesting commentator proposals, which were not adopted by the regulations. Commentators suggested various distinctions between different nursing home businesses (based on billing practices, capital investments, or revenue breakdown). Others asked for clarification on when two separate activities would be viewed separately, particularly for facilities such as emergency centers, urgent care centers, and surgical centers, that provide real estate and equipment but do not directly provide treatment or diagnostic care. Some commentators requested clarification on whether a retail pharmacy selling pharmaceuticals or medical devices is engaged in health. One commentator suggested that gene therapy and other similar therapies should not be treated as health. One commentator argued that services do not rise to the performance of services in the field of health unless they are performed directly to the patient. Treasury declined to adopt these suggestions and said that each question must be judged based on its facts and circumstances.

<sup>27</sup> It says the explanations "apply solely for purposes of section 199A and therefore may not be taken into account for purposes of applying any provision of law or regulation other than section 199A and the regulations thereunder, except to the extent such provision expressly refers to section 199A(d) or this section." Reg. section 1.199A-5(b)(2)(i)(A). This point is echoed in reg. section 1.199A-5(a)(1) ("The provisions of this section apply solely for purposes of section 199A") and the preamble to T.D. 9847.

And in LTR 202418001, the IRS ruled that a company that provided tests to its customers based on orders from their physicians was not a business engaged in health services within the meaning of section 1202(e)(3). The letter ruling noted that the company's employees used specialized equipment and software and prepared a report for the customers' physicians but did not engage directly with the customer and did not diagnose or provide medical advice.

#### IV. Factors to Consider

When analyzing the qualification of a health-related business, tax advisers can look to the various factors mentioned in the above authorities. In summary, these factors (some more significant than others) are:

- whether the company employs doctors, nurses, and other healthcare professionals;<sup>28</sup>
- whether the company's employees are regulated under laws relating to medicine;<sup>29</sup>
- whether the company's employees must be licensed and certified;<sup>30</sup>
- whether the company's personnel diagnose, recommend, treat, or manage any aspect of any patient's care;<sup>31</sup>
- whether the company provides a service rather than a product or a tool;<sup>32</sup>
- whether the company's revenue is generated by services performed rather than the sale of a product;<sup>33</sup>
- whether the company has direct contact with patients, and whether any such interaction is more than incidental<sup>34</sup> (interaction that takes place remotely can still constitute interaction);
- whether the company merely conducts research, testing, manufacturing, and/or sales;<sup>35</sup>

- whether the services are directly related to a medical field rather than general physical exercise or conditioning;<sup>36</sup> and
- whether the employees are more similar to physicians and nurses (providing evaluation, treatment, instruction, and administration of services for the purpose of assessing, preventing, correcting, or alleviating physical disability or pain) or to employees of health clubs or health spas (providing physical exercise or conditioning).<sup>37</sup>

#### V. Additional Observations

A corporation sometimes derives its revenue and profits from more than one service line, only one of which constitutes a QTOB. In that case, it is sometimes unclear whether the corporation satisfies the QTOB requirement.

A close read of section 1202 indicates that the key language relevant to that fact pattern is in section 1202(e)(1)(A), which states that stock is QSBS only if "at least 80 percent (by value) of the assets" of the corporation are used by the corporation "in the active conduct of 1 or more qualified trades or businesses."<sup>38</sup> Accordingly, in a situation in which a corporation has two service lines and at least 80 percent of its assets — including intangible assets such as goodwill — are used in a service line that is a QTOB, that corporation's stock can qualify as QSBS.<sup>39</sup>

**Example 1.** A corporation primarily develops pharmaceutical drugs. In that primary service line, the company employs several doctors, but they do not diagnose, treat, or interact with patients in that service line, and the company derives its revenue and profits from sales of its

<sup>36</sup> See, e.g., reg. section 1.448-1T(e)(4)(iv) (temporary regulation).

<sup>37</sup> See, e.g., LTR 9222004. See also Zia-Ahmadi, T.C. Summ. Op. 2017-39.

<sup>38</sup> Section 1202(a)(1) provides that the section 1202 exclusion applies only when the stock sold is QSBS. Section 1202(c)(2)(A) provides that stock does not constitute QSBS unless the corporation meets the active business requirements during "substantially all of the taxpayer's holding period" of the stock. Section 1202(e)(1)(A) provides that the active business requirement can be met only if "at least 80 percent (by value) of the assets" of the corporation are used by the corporation "in the active conduct of 1 or more qualified trades or businesses."

<sup>39</sup> See, e.g., LTR 202114002 (in analyzing whether a corporation conducted "brokerage services," the IRS considered whether one of the corporation's two services qualified, after obtaining a representation that at least 80 percent (by value) of the assets of the business were used in the conduct of that service).

<sup>28</sup> See, e.g., *Eure*, T.C. Memo. 2007-124.

<sup>29</sup> See, e.g., LTR 202221006.

<sup>30</sup> See, e.g., LTR 202125004.

<sup>31</sup> See, e.g., LTR 201717010; LTR 202221006; and LTR 202418001.

<sup>32</sup> See, e.g., LTR 202125004.

<sup>33</sup> See, e.g., LTR 202221006.

<sup>34</sup> See, e.g., LTR 201717010; LTR 202221006; and LTR 202418001.

<sup>35</sup> See, e.g., reg. section 1.199A-5(b)(2)(ii).

drugs to hospitals. The company also operates a second service line, a small legacy business under which its doctors diagnose, and prescribe medication to, a handful of patients who can benefit from the corporation's drugs. However, the vast majority of the corporation's (tangible and intangible) assets are used in its primary business line of developing drugs, and the corporation uses its reputation in the marketplace as a drug developer to advance its sales of drugs.

Assuming the primary service line constitutes a QTOB and all other section 1202 requirements are met, this corporation's stock would qualify as a QSBS.

Contrast Example 1 with a corporation that has only one service line but engages in various activities and employs various types of employees to support and advance that service line. In that case, it appears that determining whether the corporation is a QTOB simply hinges on the nature of the services offered under the service line.

**Example 2.** A corporation operates a medical practice that focuses on patients suffering from a certain rare disease and employs a single doctor who examines, diagnoses, and treats patients. The practice also employs nine nonmedical employees to handle various administrative needs — billing, insurance negotiations, research, advertising, and assistance with technicalities. The corporation's revenue is derived solely from patients and their insurance companies.

In this case, almost all of the practice's employees are not medical practitioners, and many of its activities do not constitute healthcare services per se. Nevertheless, because the practice's revenue and profits are derived from a non-QTOB, its nonhealthcare components would likely be viewed as merely supporting the healthcare component, which does not qualify as a QTOB.

Moreover, when considering the services provided by a corporation, care must be taken to properly identify the true underlying driver of the corporation's (tangible and intangible) asset value.

**Example 3.** A corporation provides healthcare administration services. Its employees are not licensed medical providers and only handle administrative matters. The corporation contracts

with doctors to provide medical services (diagnosis and treatment) to patients. The doctors are not employed by the corporation; they are independent contractors. However, the corporation has structured its services such that it bills the patients (or the patients' insurance companies) for the healthcare services provided by the doctors and then pays an hourly fee to the doctors for their services.

This corporation appears to be engaged in the service of health. Its revenue is derived from the health services provided by its independent contractors, the doctors. The argument that its assets (tangible and intangible) are used in the QTOB of administrative services and not health services appears overly simplistic, because its administrative services are designed to merely support the principal business of the corporation, which consists of providing healthcare services to patients through its independent contractors.

In situations like this, in which the corporation contracts with other parties (whether directly with medical providers or with a company that hires providers), it appears that a key factor is which party is responsible for the health services and to bill the patients (or their insurance company). If a corporation holds itself out as responsible for the health services and bills patients for those services, that indicates the corporation is providing health services, even when it contracts with another party to provide the health services.<sup>40</sup>

As noted above, new modes of technology raise novel questions about the scope of health services.

**Example 4.** A company develops technology that connects doctors to patients suffering from a specific ailment. The company sets up doctor visits through its automated technology. The company then bills the patient's insurance company, retains a portion of each payment for itself, and sends the remainder of the payment to the doctor, all through its automated technology.

Because the company is responsible for, and derives its revenue from, the doctor visits, it arguably does not qualify as a QTOB.

<sup>40</sup> See reg. section 1.199A-5(b)(3), Example 2 (noting that health services were billed directly by the healthcare providers).



If the company did not collect payments from insurance companies but merely connected doctors to patients and collected a fee from its member doctors, it arguably would not be performing health services.<sup>41</sup>

**Example 5.** A company provides management services to a practice entity through the so-called friendly doctor model. Under this model, the management services organization (MSO) provides nonmedical administrative services. The medical company — not the MSO — bills the patients. However, the MSO often holds all the benefits and burdens of ownership in the medical company. In this case, the MSO itself may often be treated as engaged in health services.<sup>42</sup>

These examples illustrate that the precise services provided by a corporation are not always self-evident. Accordingly, a corporation seeking to determine whether its stock is QSBS should focus on whether it truly provides a QTOB service in which 80 percent of its assets, including intangible assets such as goodwill, are actively used.

## VI. Conclusion

Section 1202 provides a highly valuable tax benefit to qualifying taxpayers, and many companies therefore go to great lengths to ensure that their stock qualifies. The above discussion illustrates that while not everything colloquially viewed as health constitutes health for section 1202 purposes, many business types clearly constitute health services — though some fall into a gray area.

Tax advisers grappling with these questions can analogize to some of the authorities cited — and factors summarized — above. Ideally, Treasury or the IRS will supplement the above authorities with further clarifying guidance. ■

<sup>41</sup> But it might arguably be treated as performing “brokerage services,” another business specified in section 1202(e)(3) as not qualifying as a QTOB. See, e.g., ILM 202204007 (website company connecting lessors and lessees of real property was not a QTOB).

<sup>42</sup> For more on this subject, see Nick Gruidl, Gottshalk, and Wiener, “Comments Addressing ‘Friendly Doctor’ Transactions, Ownership of Property for Federal Income Tax Purposes, and Potential Precedential Guidance” (June 13, 2022); and Gruidl and Wiener, “Who Really Owns That Medical or Professional Practice?” RSM Tax Insights (Jan. 13, 2021).

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