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SENSIBLE SOLUTIONS

winter 2021

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About Our Law Firm

We are comprised of seasoned and dedicated professionals who familiarize themselves with our clients' industries as well as their legal issues. We strive to maintain long-term client relationships by keeping our clients fully informed and respecting their time and business resources.

Legal Practice Areas

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- Condo-Community Association Representation
- Corporate and Other Business Transactions
- Defamation, Privacy and First Amendment
- Employee Benefits
- Employment Law
- Estate Planning, Probate and Trust Administration
- Health and Fitness Industry
- Independent Sales Representatives
- Intellectual Property Law
- Litigation and Alternative Dispute Resolution
- Mergers, Acquisitions and Business Sales
- Real Estate and Finance
- Real Estate Tax Reduction
- Securities, Futures and Derivatives
- Trade Associations

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Toss or Keep? Taming the Paper Pile

The past year has provided us much to reflect upon, including our dependence upon our files and records. Whether telecommuting or working with a reduced staff in the office, it may be time to declutter the office or clean out the file room.

Organization is a valuable tool in any aspect of business, but especially in records management. Despite the desire to dispose or destroy records, some records should be kept permanently, or for a specified period of time. Yet, with ever increasing costs for office space, perhaps it is time to review your records retention, destruction, and file maintenance policy.

Regardless of whether the paper copy or digital copy is preferred, establishing a system and policy for records management can be an important tool for improving efficiency and reducing costs of storage. In the event of investigation, audit or litigation, a document management policy will offer ease in locating the document and provide an impartial and valid purpose for retention or destruction of documents. Records management policies should be reviewed with counsel for compliance with federal and state law and industry-specific regulations.

Records retention, destruction, and file maintenance policies include both tax and non-tax records. Corporate records, such as incorporation papers, bylaws, charters, operating agreements, meeting minutes and stock records, are examples of permanent records. Many insurance and legal records are also permanent in nature. However, a frank discussion with your insurance agent and your legal counsel is encouraged.

Other policy considerations for non-tax records are service, vendor and sales agreements. Enforcement statutes related to these types of agreements help provide guidance for setting the file retention period. Records for vendor agreements, customer purchase orders, service agreements, and related non-disclosure agreements are often retained for the period of the agreement plus six years. However, some states maintain ten-year statutes of limitations for contract actions.

Personnel and payroll records retention require special care due to immigration laws, the Family and Medical Leave Act, HIPPA, OSHA, and other state and federal laws. General personnel records such as background checks, performance reviews, and salary information are often retained for a six-year period following the employee's departure from the company. Benefits plan records also are retained for a six-year period following termination of the plan. However, pension and retirement plan records are of a permanent nature.

At the heart of most company files are the financial records. Ledgers, audit reports, audited financial statements, and check registers are permanent records. Generally, most other accounting records, such as bank statements and audit work papers are retained for a period of seven years beyond the current year. Other accounting records, such as monthly financial statements, aging reports, and cash receipts records are retained for a six-year period beyond the current year.

The Internal Revenue Service recommends that records for income, deductions, or credits, be retained for the limitations period ascribed for such records. Generally, tax related records are kept for a period of three years after the filing of a return, claim for refund, or payment of the tax due (whichever is later). However, employment tax records are retained for at least four years after the later of the date when the employment tax is due or is paid. Records regarding bad debt or worthless securities should be retained for a period of seven years.

An exception to the general retention recommendations pertains to real estate records. Tax records for real estate should be held for the limitations period after the sale of the real estate. However, if the real estate is sold as part of a tax deferred exchange, the records should be retained for the limitations period after the sale of the new property. The records include those documents used to compute any depreciation, amortization, or depletion deduction and to determine the gain or loss when you sell or otherwise dispose of the property.

Of interest, the IRS recommends that records be kept for six years regarding unreported income exceeding 25% of gross income that should be reported. The IRS rules require that records be retained indefinitely if no return is filed or if a fraudulent return was filed.

Not all records fit neatly into a specific category. A good starting point is to determine if the records are income tax related. Some documents such as routine correspondence requiring no response may not require an extended retention period. A strong records retention, destruction, and file maintenance policy will assist in guiding the decision to keep or discard records.

If you would like your company's records retention, destruction, and file maintenance policy reviewed, or if you have questions regarding document retention, please contact Joan Berg (joan.berg@sfbbg.com) or Len Gambino (leonard.gambino@sfbbg.com), or call (312) 648-2300.

Should You Make an S Election For Your Limited Liability Company?

Special Recognitions

In November, Gerry Newman received the Distinguished Volunteer Award from the Chicago Volunteer Legal Services in honor of his pro bono work in estate planning through JUF Evelyn R. Greene Legal Services over the last several years. Gerry was also the named recipient of the Electronics Representatives Association (ERA) Lifetime Achievement Award. The ERA recognized Gerry for providing five decades of outstanding legal support to thousands of manufacturers' representatives.

Notable Publications

"Smart Ways To Handle Pandemic Tax Deferrals and Subsidies" (*Forbes*, October 9, 2020, Bruce Bell)

"Toying with Rep Over Post-Termination Commissions Ends in 'Game Over' for Opportunistic Principal" (*The Representor*, Fall 2020, Gerry Newman & Adam Glazer)

"How To Blunt the Impact of Biden Tax Hikes" (*Forbes*, December 8, 2020, Bruce Bell)

"How To Give Adult Children Money For a Home, and Avoid Tax Problems" (*Forbes*, January 14, 2021, Bruce Bell)

"Illinois "SLAPP" Cases Between Citizens of Different States Pose Unique Conflicts and Jurisdictional Issues" (*Law360*, January 15, 2021, Phil Zisook)

Attorney Quoted

Michael Kim was quoted in Community Association Management Insider on November 2, 2020 in an article entitled "Continuity Planning: Don't Let Your Clients Get Left in the Lurch," and on November 4, 2020 in an article entitled "Court Upholds Annual Meeting by Phone During Pandemic."

Webinar

Andrew Weissman hosted a CLE webinar "The New Subchapter V of the Bankruptcy Code: A New Way for Small Businesses to Reorganize" on October 2, 2020.

A limited liability company ("LLC") may elect to be taxed as a partnership, a C Corporation, an S Corporation, or as a disregarded entity. Many LLCs elect to be treated as "S Corporations" for federal income tax purposes in order to minimize employment taxes. Each owner of an LLC which is taxed as a partnership or as a disregarded entity is treated as being self-employed for tax purposes, and all amounts paid to such owners who also provide services, whether as compensation for services or as distributions, are subject to Social Security and Medicare taxes. An owner of an LLC taxed as an S Corporation, however, can be treated as an employee of the LLC. Thus, only his or her salary will be subject to Social Security and Medicare taxes, but any dividends received will not be subject to these taxes.

An S Corporation owner-employee, however, must pay him or herself a salary that is at least what other comparable businesses pay for similar services. Moreover, in order to maximize contributions to retirement plans, it can be advantageous for an S Corporation to pay substantial salaries to its owner-employees. As a result, the employment tax savings may not be significant.

Moreover, there are a number of drawbacks for a limited liability company being taxed as an S Corporation as opposed to being taxed as a partnership. For example:

1. An S Corporation cannot have more than 100 shareholders.
2. An S Corporation's shareholders must be U.S. citizens or resident individuals, or certain types of trusts and tax-exempt organizations. Thus, a partnership or corporation may not own an interest in an S Corporation.
3. An S Corporation may have only common stock, which may be voting or non-voting. S Corporations cannot issue preferred stock, profits-only interests, or stock with special allocations or changing profit sharing ratios. This limits the LLC's ability to raise capital from investors who expect a preferred return on their investment.
4. Service businesses may not often have the need to raise capital, but they often desire to provide key employees with an ownership interest in the business as a means of succession planning. An S Corporation, however, cannot issue equity in the form of a so-called "profits-only interest" to an employee in exchange for the employee's services, and any stock issuance to an employee will be taxable to the employee based on the fair market value of the equity interest issued.
5. An S Corporation that was previously a C Corporation and that has earnings accumulated from its C Corporation years can have no more than 25% of its income from passive sources. Passive income is income from an endeavor in which the company does not actively participate, such as investment income and most types of rental income. The S Corporation will pay corporate tax on any passive income that exceeds 25% of its total income. If more than 25% of its income is passive for three consecutive years, the company's S Corporation status will terminate.
6. If the shareholders of an S Corporation decide that it would have been better to be taxed as a partnership, the LLC cannot change its tax status without being taxed as if it had sold all of its assets and dissolved.

In those cases in which the above limitations will not likely be meaningful, then self-employment tax savings may prove useful. For example, an individual who provides consulting services through his single member LLC could elect S Corporation status for the LLC. The company could pay him or her a modest salary which would be subject to applicable employment taxes, and have the remainder of the income paid as a dividend which would not be subject to any employment taxes. If this business were conducted as a sole proprietorship or as a single member LLC taxable as a disregarded entity, all of the taxable income of the business would be subject to employment taxes. As noted above, salaries paid to S Corporation owners cannot be unreasonably low.

In our experience, some professional advisors tend to favor one form of taxation over the others without considering the LLC's and its owner(s) needs in each case. Choosing the best approach to income taxation, however, is not a "one size fits all" situation, and making the wrong choice can be both expensive and difficult to fix.

For more information, please contact Len Gambino at Leonard.Gambino@SFBBG.com or call 312-648-2300.