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## File Articles of Incorporation or Articles of Organization? The Letter S v. The Acronym LLC

**Bart A. Basi, CPA/Attorney at Law**  
**The Center for Financial, Legal & Tax Planning, Inc.**

### Introduction

For the closely-held business, choosing a business entity under which to operate used to be easy. The proprietor usually operated as a sole proprietorship, a partnership, or as an S Corporation. There were clear advantages and disadvantages to each one. The sole proprietorship and partnership had the advantage of simplicity and lack of formal arrangements. The S Corporation was for those individuals needing asset protection and a formal entity in which to operate.

Today the choice of business structure is not so easy. Generally, the use of sole proprietorships and general partnerships is very limited to home based businesses. Currently, most business people have the choice between operating as a Limited Liability Company or as an S Corporation. When deciding which entity to operate under, the business owner must take a lot into consideration. This month, we will focus on the comparison on the Subchapter S Corporation versus the LLC from the perspective of a business owner looking at the newer of the business entities, the Limited Liability Company.

### The Limited Liability Company Ownership

An S Corporation does have restrictions on ownership. First, in order to hold an S Corporation status, a stockholder must be a resident and citizen of this country. Second, no more than 100 people are allowed to own the stock of an S Corporation at any one time. If the ownership requirements are violated, the company will lose its S Corporation status and it will not be allowed to hold S Corporation status for a number of years.

With an LLC, these restrictions (citizenship and limit on number of shareholders) do not exist and its status is not jeopardized. While most LLCs will maintain membership of well under 100 members, the option to expand the number of investors rapidly, does exist. Many immigrants just starting business can benefit from this form of business. On the other hand, a business owner, operating as an LLC has the advantage of looking to non-citizens as investors, yet increasing selling potential.

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## A CASE STUDY

### Pay Your Taxes!

The IRS has created a regulation where a third party payer or professional employer organization (PEO) can be held as a responsible party if payroll taxes are not paid. Unless an exception applies, the third party payer would be designated an agent of the employer under section 3504 of the Internal Revenue Code.

Under the new rule, some situations are excepted as third party responsible persons.

The three exceptions are:

- 1) The wages or compensation are reported on a return filed under the client's EIN,
- 2) The payer is a common paymaster, or
- 3) The payer is the employer or the individual(s).

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**Formalities**

There are fewer formalities in maintaining an LLC as opposed to an S Corporation. This is a major convenience and aides in limiting tort and contractual liability; however, the LLC and S Corporation are both potentially subject to being disregarded as an entity if the owner does not obey statutory formalities. This process of disregarding the entity in court is what is known as “veil piercing”. Generally, it happens when company owners do not observe formalities such as annual meetings, failure to elect officers, record meetings, keep paperwork, and otherwise use the business as an “alter ego”.

The advantage here is that the LLC does not require as many statutory formalities as S Corporations. Hence the LLC can be a better insulator against liability if the occurrences of meetings and production of documents is going to be an issue.

Shares of an LLC are easier to put into a trust than an S Corporation. To put shares of an S corporation into a trust, special language and provisions must be used. It can be somewhat complicated and LLCs tend to work very well instead of S corporations for the purposes of trusts in transfer, estate, and business succession scenarios.

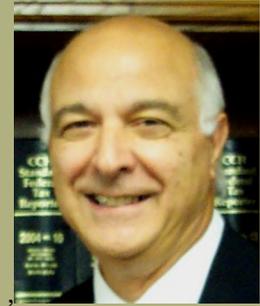
**Taxes**

During operation of an LLC, profits are taxed only at the shareholder level, the same as an S Corporation. Profits from the operation of the business “flow through” to the income statement of the owner. This does not mean distributions are taxed immediately; the income (revenue minus expenses per the tax return) of the LLC is taxed to the owner. This can be a significant disadvantage if the LLC does not pay out distributions. Owners can find themselves facing large tax bills without the cash to cover it if the LLC has large profits, yet regular distributions are not made.

When winding up the affairs of the entity and dissolving, gains are taxed once. Nearly all businesses will eventually close their doors. Both the LLC and the S corporation offer the owners the chance to close the doors and be taxed only once on the sale of the assets.

**Conclusion**

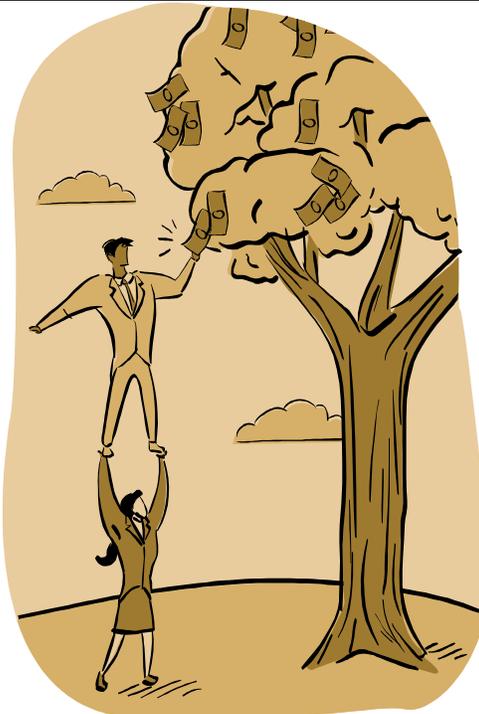
Limited Liability Companies are becoming more popular. This is because most business owners want a limit on liability, single layer taxation, want to limit the formalities and still enjoy the protections. The LLC is definitely worth consideration, next month we will look at the issue from the vantage point of the proprietor looking to operate as an S Corporation.



*Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the Financial, Legal & Tax Advisory which may be read in various industry-specific trade publications.*

**Points of Interest**

- ...the LLC does not require as many statutory formalities as S Corporations.
- To put shares of an S corporation into a trust, special language and provisions must be used. It can be somewhat complicated and LLCs tend to work very well instead of S corporations
- The LLC is definitely worth consideration, next month we will look at the issue from the vantage point of the proprietor looking to operate as an S Corporation.



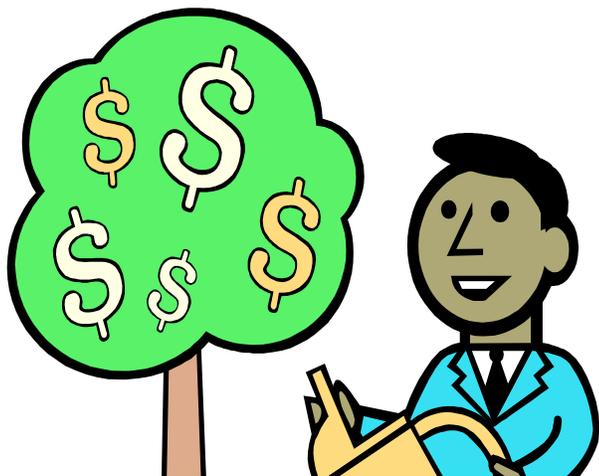
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## A CASE STUDY CONTINUED:

**Editor's Comment:** In many tax cases that involved employee withholdings, many taxpayers pointed to a third party payer when the IRS came for collection. The taxpayers' logic in the past has been that they paid the withholding amounts to a third party who was under legal obligation to pay the tax due. Because the third party never paid the amount due as the employer had, the third party payer, not the employer should be responsible for the taxes. Seeing this as opportunity, the IRS has brought in this regulation. In effect, not only is the employer a potential responsible person, so is the third party payer, who is rightfully the one with responsibility.

I would like to further add that employee withholdings are tempting sources of money in which small employers do readily invade to pay bills. Under the law, you are not the owner of the money, you are a trust of the money, hence trust fund penalty recovery. Pay the withholdings to the government or face its wrath. Once into adverse tax situations, it is difficult and expensive to get out of them. Steer clear of this issue.



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## Is This the Right Time to Sell Your Business?

*More and more business owners are asking me that question these days. Given the recent performance of the US economy and stock market, it's a very fair question.*

*My answer is generally in two parts. First, for most business owners, determining the right time to sell your business depends upon a great many factors, including your health, your spouse's health, your retirement plans and retirement savings, your management succession plan, the current financial health of your business and its immediate prospects for the future, and last but not least, the state of the overall economy, just to mention the most obvious factors. Clearly, this is not a question that can be answered without a careful analysis of many, interrelated factors. Equally clearly, there is no one time that is right for every company and owner.*

*The second part of my answer goes something like this: Now that the US economy is back on its feet again and beginning to surpass previous records, and now that bank financing for business acquisitions is more available - and still at historically low interest rates - this could be a particularly good time to sell your company.*

*While there is almost always a market for a really well run company with a proven track record of generating above average cash flows, and with bright prospects for continued future growth, most companies sales and cash flows have generally returned to the high levels they achieved prior to the Great Recession.*

*If you're nearing retirement age, for sure you'll want to think seriously about selling before the next major economic recession. Strategic buyers, private equity groups, and family offices all seem to be in a strong position to fund their deals and are actively looking to source new deals to add-on to their existing platforms and to form new platforms.*

*In view of the above, a better question might be: What can I be doing now to maximize the value of my company when I'm really ready to sell?*

*We've addressed some specific strategies to maximize business value in previous articles. Now may be the perfect time, when the business is not yet stretched to its limits, to invest in actually implementing those value improvement ideas. As the economy continues to improve, most business owners will once again be so busy trying to keep up with the growing demand for their products and services that they will quickly complain that they simply don't have the time to make needed improvements. This time around, commit to yourself that you won't fall into that mental trap.*

*If you'd like to receive a complimentary copy of our whitepaper entitled: Value Drivers to Maximize the Selling Price of Your Business, contact me at:  
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## Frequently Asked Questions...



**Q: What are the standard mileage rates for 2014 and 2015?**

**A: 57.5 cents per mile for business miles driven, up from 56 cents in 2014  
23 cents per mile driven for medical or moving purposes, down half a cent from 2014  
14 cents per mile driven in service of charitable organizations**

**Q: If I use standard mileage rate in place of actual expenses, do I also need to figure depreciation of the vehicle?**

**A: You cannot depreciate the vehicle if you use the standard mileage rate.**

**Q: I own a business and use a vehicle for business travel. On what form and line do I deduct the standard mileage rate?**

**A: Many taxpayers find using the standard mileage rate an easier way to expense their vehicle. It depends on what type of business you have concerning where the mileage is taken as a deduction. Alternatively, instead of the standard mileage rate, you can use the actual expense method. If you use the actual expense method, you need to figure depreciation for the vehicle.**

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