THIS BINDER IS YOUR REGULATORY COMPLIANCE MANUAL. EACH BINDER CONTAINS THE FIRST COMPLIANCE ISSUE (RECORDS RETENTION) WITH OTHER ISSUES TO FOLLOW. PLEASE PLACE AND ALL FUTURE COMPLIANCE UPDATES IN THIS BINDER.

THE ALLIANCE WOULD LIKE TO THANK FISERV/FSC INSURANCE SOLUTIONS AND APOLLO AGENCIES INC. INSURANCE FOR THEIR SUPPORT.
DISCLAIMER

The information contained in this article represents the best information currently available to us. It is not intended that you rely exclusively upon this article; you should research your responsibilities. Laws and regulations change frequently. It is your own responsibility to check frequently for changes and updates which occur. The information in this article is advisory only and does not substitute your own research and determination of your obligations.
Part 1
Record Retention Regulation for Agents and Brokers
SECTION A

Customer Records
Section A
Customer Records

Even with the advent of scanners, DVD storage and other space savings devices, the do’s and don’t of record retention are a potential trap for the unwary, not to mention the problem of cataloging and storing the records, but good record keeping practices can protect you and also give you an opportunity to provide essential service to your customers.

**PRACTICE TIPS REGARDING RECORD RETENTION: MINIMUM LEGAL REQUIREMENTS**

<table>
<thead>
<tr>
<th>Records regarding insurance placement and policy (10 Cal. Admin. Code section 2190.2, below)</th>
<th>5 YEARS</th>
</tr>
</thead>
<tbody>
<tr>
<td>The entire “file” regarding a customer (10 Cal. Admin. Code section 2190.3, below)</td>
<td>18 MONTHS</td>
</tr>
<tr>
<td>Records of a “claim” or activities relating to a claim (10 Cal. Admin. Code section 2691.14, below)</td>
<td>5 YEARS</td>
</tr>
<tr>
<td>Records which may have a tax ramification to you or your customer (see below)</td>
<td>3 YEARS</td>
</tr>
</tbody>
</table>
The quote or legitimate business purpose for ordering the MVR must be saved for a minimum of 2 years; however, the MVR must be deleted as soon as there is no longer a legitimate business reason to keep it in your computer or file. Under no circumstances may the MVR be kept more than 2 years. **Refer to The Alliance of Insurance Agents and Brokers Specimen Motor Vehicle Record Compliance Manual**

| Premium quotation and records of an unsuccessful placement for a new or non-renewal customer (our suggestion based on “gray area” of law – see discussion below) | 18 MONTHS |

**WHY SHOULD I KEEP RECORDS OF INSURANCE TRANSACTIONS? AFTER ALL, THE INSURANCE COMPANY HAS TO?**

The simple and most direct answer is that you MUST keep records of your insurance transactions for AT LEAST 5 years after the expiration or cancellation date of ANY type of policy you participate in transacting (see below for a more complete discussion). This is the required length, and is the minimum you should follow.

Even without that legal requirement, your own protection and a service to your customer may result in a decision to keep the records for even longer. Your records serve as proof of your actions (essential in the event of a subsequent dispute) and in some cases may be all that your customer may have to establish coverage in the event of a claim that can possibly extend back as far as 10 years or even more. In order to understand the potential importance to you and your customer, we will need to explore California statutes of limitations and also the kinds of claims that may extend for decades.

**FOR HOW LONG AM I REQUIRED BY LAW TO MAINTAIN MY RECORDS OF AN INSURANCE TRANSACTION? WHAT RECORDS MUST I RETAIN?**

According to the California Administrative code, EVERY agent, broker, surplus lines broker, or special lines broker is required to keep the following records for at least 5 years after the expiration or cancellation of the policy to which the records pertain (10 Cal. Admin. Code Title, section 2190.2). Those records are:

(a) Name of insured,

(b) Name of insurer,
(c) Policy number,

(d) Effective date, termination date and midterm cancellation date of coverage,

(e) Amount of gross premium,

(f) Amount of net premium,

(g) Amount of commission and basis on which computed,

(h) Names of persons who receive, or are promised, any commissions or other valuable consideration related to the transaction,

(i) Amount of premium received including itemization of any partial payments or additional premium,

(j) Date premium received by agent or broker,

(k) Date deposited in bank account or bank depository into which premiums are deposited or maintained in accord with Section 1733 of the Insurance Code, including but not limited to trustee accounts maintained pursuant to Section 1734 of the Insurance Code,

(l) Name and address of bank and number of account in which premium is deposited or maintained in accord with § 1733 of the Insurance Code, including but not limited to trustee accounts maintained pursuant to section 1734 of the Insurance Code,

(m) Date premium paid by agent or broker to the person entitled thereto and identification of the means of transmittal,

(n) Amount of net and gross return premium,

(o) Date return premium is received from insurer by agent or broker which may be the date the credit is taken from the insurer or the date the check or draft is received, and

(p) Date gross return premium is remitted to person entitled thereto by agent or broker and identification of means of transmittal.

What does all that mean? Practically speaking, this means that for your own safety, it is best to retain EVERYTHING you have concerning that transaction for that 5 year minimum. Even your notes or your phone records may have important information which you may need for your own protection or which your customer may need to
prove the insurance obtained. Needless to say, the practical problem in trying to keep only the select records required by law is that the potential for a mistake is obvious, especially because such a chore is likely to be given to your least experienced staff person. You are best advised to keep it ALL, as you will see in this article.

This practical problem is compounded by the next legal requirement, that of maintaining the “file” regarding that customer for a period of 18 months, but it also requires that some parts of the file be kept for a minimum of five years. As set forth below, 10 Cal. Admin. Code Title, section 2190.3 mandates that you keep the records specified by an “insured” 18 months after the transaction described in your records. It is assumed that the use of the term "insured" implies a successful placement of insurance, but it would actually be safer to assume that it has application to any customer seeking insurance. This is especially true if the customer contact resulted in the charging of a broker or other fee. For such "files" of a "particular insured," the rule reads as follows:

(a) Wherever applicable, the following records shall be maintained by every agent or broker and surplus lines broker and special lines' surplus lines broker in a file pertaining to a particular insured for a period of eighteen months after the transaction described by such records:
   (1) Identity of each person who transacted the insurance, renewals and any change in coverage,
   2) Records of all binders, whether written or oral, showing the names of insured and insurer, nature of coverage, effective and termination dates and premium for binder or policy to be issued,
   (3) Copy of application or memorandum of request for insurance,
   (4) Correspondence received, copies of correspondence sent, memoranda, notes of conversation, or any other record necessary to describe the transaction.

(b) The following records of surplus line transactions shall be maintained by every agent and broker and surplus lines broker and special lines' surplus lines broker for a period of at least five years after expiration or cancellation date of the policy to which the records pertain: forms, reports or statements required to be maintained or filed under Insurance Code §§ 1763 and 1764.1.

(c) The agent, broker, surplus line broker or special lines' surplus lines broker who signs the form, report or statement under Insurance Code §1763 shall maintain the original. The agent, broker, surplus lines broker or special lines' surplus lines broker who receives the originally signed disclosure statement under Insurance Code §1764.1 shall maintain the original.

(d) The agent, broker, surplus line broker or special lines' surplus lines broker who signs the diligent search form under Insurance Code §1763 or receives the originally signed disclosure statement under Insurance Code §1764.1 shall send copies to all other agents, brokers, surplus lines brokers or special lines' surplus lines brokers involved in the transaction.
(e) The agent, broker, surplus line broker or special lines' surplus lines broker who receives copies of documents pursuant to 2190.3(d), shall maintain the copies which show the signature of the agent, broker, surplus lines broker, special lines' surplus lines broker or applicant who signed it.

As you can see, it would be a very hard task to correctly maintain the records in a situation where you keep some of the records for only 18 months but other records you must keep for five years. To avoid clerical mistakes that could be disastrous, you should simply make a practice of maintaining all records for at least five years after the expiration or cancellation of a policy of insurance. To be safe, since you may not know exactly when such a policy is canceled, or if it is an extended policy of some type with multiple policy years, maintaining records for at least seven years would be the most cautious approach.

**WHAT ABOUT RECORDS OF A CLAIM MADE UNDER A POLICY OR A TRUST OR OTHER FINANCIAL TRANSACTION?**

Two other types of situations have specific relevance to your role as a broker or agent. If there is a claim made under a policy in which you were involved in the transaction, you must maintain the records pertaining to that claim which were received by you and are in your possession (you do not have an affirmative obligation to go out and procure the claim file of the Insurance Company) for a minimum of 5 years. This is spelled out in 10 Cal. Admin. Code Title, section 2691.14 which states:

A copy of all records relating to claims or loss adjusted or investigated and all activities in connection with investigating, adjusting, appraising or otherwise participating in the disposal, settlement, or investigation of any claim under or in connection with a policy of insurance or any other activity set forth in Insurance Code § 14021 shall be maintained at and shall be available for inspection by the Department of Insurance at the location from which the business was conducted or transacted for at least five years from the date such business was conducted or transacted. Personnel and financial records may be maintained at the principal office of the licensee but must be furnished to the Commissioner within ten days of his request for production of such records.

**Ca. Insurance Code § 14021** activity is defined as one involving an insurance adjuster other than a private investigator who engages in business or accepts employment to furnish, or agrees to make, or makes, any investigation for the purpose of obtaining, information in the course of adjusting or otherwise participating in the disposal of, any claim under or in connection with a policy of insurance on behalf of an insurer or engages in soliciting insurance adjustment business or aids an insurer.

As for other financial transactions, there are several potential issues. First, it is important to know that your receipt of premium or return premium potentially creates a fiduciary
responsibility on your part with regard to that money. In essence, you may be the trustee of any funds received as premium or return premium.

§ 1733 of the Insurance Code states:

All funds received by any person acting as an insurance agent, broker, or solicitor, life agent, life analyst, surplus line broker, special lines surplus line broker, motor club agent, bail agent, permittee, or solicitor, as premium or return premium on or under any policy of insurance or undertaking of bail, are received and held by that person in his or her fiduciary capacity.

This potentially impacts your record keeping requirements because any financial transaction at least has the potential of involving a tax issue, for which there is yet another record keeping requirements, this time of three years for the Franchise Tax Board itself, and thus it would be prudent to keep all financial records for a minimum of three years.

In light of the problems outlined above concerning different time periods at issue, we cannot stress a strongly enough that good practice mandates a minimum retention of five years.

**WHY DO YOU THINK IT IS POTENTIALLY IMPORTANT TO KEEP RECORDS EVEN LONGER THAN 5 YEARS?**

After all this legal discussion (which we hope was not too boring), we have hopefully shown you why it is legally important to maintain your files and records on any insurance transaction, even an unsuccessful attempt at placing insurance for a customer, for a minimum of five years after the cancellation/expiration of the policy. That is the standard of care for a broker/agent, as mandated by the regulations. It would not be reasonable to require more, given the cost and administrative burden.

However, it is our suggestion that you make an effort to consider the feasibility in your practice of keeping records for even longer. To understand the potential service to your customers and to yourself of “going the extra mile” in keeping these records longer than required, we need to review some of the statute of limitations issues and practical realities of California litigation.

First of all, your own protection suggests that you might want to keep your records for a length of time well beyond the five years. It is an unfortunate reality of practice as an agent or broker that you are a convenient target if any claim or litigation is not resolved to the satisfaction of the customer. Even a situation in which an insurance company wrongfully denied a defense to its insured was recently held by a court to still allow a claim against the broker for failing to procure a policy that would not have been “as likely” to have been wrongfully denied by the insurance company.
The unfortunate reality for agents and brokers is that your involvement in such claims may not occur until many years after the insurance transaction has faded from your memory, and possibly from your records.

As amazing as it may sound, it is possible that claims could be made against you or against your customer decades after an insurance transaction. While it is less likely that claim could be made against your customer for such a period of time if they have claims made policies, it is still possible for claims to be made against you for alleged malpractice with regard to the placement of such claims made policies. So, for safety's sake, you might want to keep the records for a very long time.

Let's start with the basics of some of the statutes of limitations that would apply. A policy of insurance is, of course, a written contract. As such, a claim based upon the breach of a written contract has a statute of limitations of four years from the date of the breach. If that breach occurs near the very end of a policy term, then you can see that the five-year time period can be almost entirely exhausted just by that delay.

Once a lawsuit is filed, the outside maximum for service of the lawsuit is three years, although courts have adopted rules designed to speed up that process. Even that time period would not be enough for a completely “bullet proof” retention policy, because it is possible to add your customer or you as a defendant or cross-defendant to a pending suit well after the filing of such a lawsuit. It is also possible for the customer or the insurer to make a claim against you for indemnity up until a minimum of one year after any settlement or judgment has become final (which can mean after a lengthy appeal process).

Even a simple automobile claim for personal injury to a minor can possibly result in a very lengthy time period going by before you become aware of a problem. In California, a minor who is injured does not need to file a lawsuit until their 19th birthday. Practically speaking, such delays are not frequent, but they can occur. Since automobile policies are almost entirely written on an "occurrence" basis, the policy of insurance that would be implicated in any injury to a one-year-old child would be the one in effect at the time of the accident. However, that child would not be obligated to file suit against your customer, the insured, until almost 18 years later.

Unless your customer is remarkable for his/her own record keeping prowess, a claim this late is likely to result in a telephone call to your office asking you to dredge up your files concerning a policy underwritten 18 years previous.

It is an unfortunate fact of California law that many kinds of claims often have very lengthy periods of time before they surface. Some of the recent land subsidence episodes in Laguna Beach are a reminder that there is a 10 year statute of limitations for a "latent defect" in a property. Therefore, your homeowner's policies or commercial policies for developers, builders or contractors could potentially have claims against them for incidents that first began to occur more than 10 years before you receive notification of the potential claim.
A California Supreme Court case has indicated that every occurrence based policy in effect during a period of time in which an undiscovered but actual property loss was occurring would have potential coverage for that loss. Taking the Laguna Beach events as an example, if it is determined that those houses were caused to slide down the hill because of negligent conduct by prior owners in over watering, or by a pool contractor building a defective and leaking pool, or by a landscape contractor designing a poor watering system or drainage system, or the like, those parties could find themselves faced with a claim that their conduct many years previous resulted in steady damage occurring throughout the intervening years and resulting in a loss occurring now.

Given the value of the homes in Laguna Beach, it should not be surprising that this could be a very important financial issue. Clearly, if one of these persons was your customer, they would be looking to you to help them obtain coverage if they were sued under such a theory.

So, you can see that it is potentially important to your customers that you retain records of insurance transactions for a very, very long time. As indicated the beginning of this article, that is a potentially crucial bit of customer service.

Just as importantly, it also provides you a measure of protection. If you have records establishing what it is you did to procure insurance for this customer, records of the conversations and choices made by the customer, and records out of the actual insurance procured, you are less likely to be subject to a claim that you failed in your duties and obligations to that customer. Even if such a claim is made against you, your records will help to provide your defense attorney with the evidence he/she will need to protect your interests.

The author of this article has participated in far too many lawsuits of remarkably old vintage (some going back more than 20 years) to feel safe in telling you that it is okay to destroy any records. For example, asbestos companies were looking for insurance policies going back into the 1930s and 1940s once the massive asbestos litigations began.

Therefore, as both a service to your customer and for your own self protection, you can consider whether it would be cost effective to retain your records longer than the required length of time. The technology to do this is, thankfully, becoming less expensive.

Of course, that “cautious” approach is above and beyond the call of duty. Remember, though, all it takes is one claim against you that you could have defended better with access to destroyed records to make the cost and bother of doing so more than worth it. Think of it as extra business insurance, which you can also use to service your customer’s needs and to give them the incentive to be loyal customers.
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(note about the author: Mr. Frederick has been a practicing litigation and coverage attorney since 1974. He has authored articles and chapters in texts on the subject of insurance coverage, and has represented insurance agents and brokers, as well as other professionals, as well as insurers in coverage matters. He has also represented numerous insureds and companies in general liability claims of all stripes. He has represented the The Alliance of Insurance Agents and Brokers in a number of matters, including appearing on behalf of our organization as a friend of the court in matters of importance to our membership. He has also served as a speaker at our annual convention.)

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SECTION B

Employment Records
In this article, we will explore both the legal requirements and the recommended practices you should follow regarding your record keeping for your own employees, including even unsuccessful applicants for employment. These practices can not only be mandatory, they can be crucial in defending your company and yourself against claims ranging from alleged unfair employment practices, alleged discriminatory hiring practices, alleged wrongful termination, alleged sexual harassment and claims for unemployment compensation, disability benefits, workers compensation and other insurance related claims.

**PRACTICE TIPS REGARDING RECORD RETENTION:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applications for employment non-hired/unsuccessful applicants (Cal. Gov’t Code section 12946);</td>
<td>2 YEARS</td>
</tr>
<tr>
<td>Personnel files and for terminated employees (Cal. Gov’t Code section 12946);</td>
<td>2 YEARS</td>
</tr>
<tr>
<td>This is the statute of limitations for Federal Unlawful Employment Practices claims;</td>
<td>6 MONTHS</td>
</tr>
<tr>
<td>Records relating to possible unemployment benefits claims by employees (Cal. Admin. Code, section 1085-2(c));</td>
<td>4 YEARS</td>
</tr>
</tbody>
</table>
Records that relate to a claim for unemployment benefits made by a person you do not consider an employee or if you claim to be exempt from providing such benefits (alleged independent contractor, for example). (Cal. Admin. Code, section 1085-2 (b))

**(SCOPE OF THIS ARTICLE):**

This article relates to your own employees and employment decisions regarding your employment of others. This article does NOT address the tax issues, that will be the subject of the third article in this management memo series.

Generally, our recommendations are based on both the legal minimum and also on what we think are the safe practices you can follow to protect yourself and your firm. In that respect, many of the legal record-keeping requirements really relate more to possible claims for benefits by the employee or ex-employee for disability or unemployment benefits, for example. In reality, the record keeping we recommend for you to consider relate more to protecting you in the event of a claim against you. For that reason, some agencies choose to keep the records for as long as possible for their own protection.

**WHAT ARE THE LEGAL MINIMUMS FOR KEEPING RECORDS ON EMPLOYEES?**

First of all, while that person is an employee, you should keep whatever records you generate regarding their employment. Some of the specific records you must keep are detailed below. The safe approach is simply to keep everything in the file. This will include their tax information and all other records you generate concerning them. It can include records of complaints made about or by them, disciplinary actions taken against them, employee reviews, etc. Some of the ordinarily generated employment records are not mandated by law, but rather by your own needs in doing business and for your own protection.

As an example, you may choose to keep records of employee reviews, complaints against the employee by customers or other employees and/or disciplinary actions taken against the employee. These records are not mandated by law, but most employment lawyers feel that such records are an important resource in the event of a wrongful termination or harassment claim against you. The legal minimum for the type of records to keep is set forth in the code regarding unemployment benefits:

Every employing unit shall keep a true and accurate work record of:

(a) All his workers and their status, i.e., employed, on layoff or leave of absence.
(b) The wages paid by him to each worker.
(c) Such other information as the director deems necessary to proper administration of this division.

The failure to keep the above records may result in a finding that an unemployment benefits claimant is entitled to the entire amount sought as explained by the statute below.

Please see below for the list of the records that have been mandated to be retained by the director as codified in the Administrative Code.

As long as that person remains in your employ, keep the records.

Once the employee terminates, then you must keep the personnel file for a minimum of 2 years pursuant to California Government Code section 12946, probably because of possible unemployment benefits claims:

“Cal.Gov.Code § 12946. Retention of applications, records and files for two years; failure to retain as unlawful practice by employers, labor organization and employment agencies

It shall be an unlawful practice for employers, labor organizations, and employment agencies subject to the provisions of this part to fail to maintain and preserve any and all applications, personnel, membership, or employment referral records and files for a minimum period of two years after the records and files are initially created or received, or for employers to fail to retain personnel files of applicants or terminated employees for a minimum period of two years after the date of the employment action taken. …. Upon notice that a verified complaint against it has been filed under this part, any such employer, labor organization, or employment agency shall maintain and preserve any and all records and files until the complaint is fully and finally disposed of and all appeals or related proceedings terminated. …. Where necessary, the department, pursuant to its powers under § 12974, may seek temporary or preliminary judicial relief to enforce this section.”

“Cal.Gov.Code § 12976. Willful violation of record keeping requirements; misdemeanor; punishment

Any person who willfully violates § 12946 concerning record keeping is guilty of a misdemeanor, punishable by imprisonment in a county jail, not exceeding six months, or by a fine not exceeding one thousand dollars ($1,000), or both.”
As you will see from the later portions of this article, there are very good reasons why you will want to keep records of your employees longer than this minimum. For actual claims for unemployment benefits, the record-keeping requirement is much longer.

**WHAT RECORDS MUST I RETAIN?**

The types of records which must be maintained for an employee are set forth in a number of enactments, including the Unemployment Insurance Code and the Administrative Code, as follows:

“**Cal.Un.Ins.Code § 1093**

“In the event any employer shall fail to keep and furnish to the director, upon notice, any required records or reports necessary for a full determination, decision on appeal, or other proper disposition of any claim for benefits in any proceeding under this division, within such reasonable time as the director may by rule, regulation, or procedure prescribe, it shall be conclusively presumed that the claimant is entitled to the maximum total amount of benefits payable under this division unless it is established by other evidence which the director deems sufficient that a lesser total amount of benefits is properly due and owing to the claimant…”

Additional reporting requirements for an employer of unemployment and disability benefits are mandated as follows:


(a) Each employing unit shall establish and maintain records with respect to each worker performing services for it which shall indicate:

(1) The period covered by the pay period.

(2) For each worker:

(A) His or her name;

(B) Social security number;

(C) The date on which he or she was hired, rehired, or returned to work after temporary layoff, and the last date when he or she performed any services;

(D) The place of his or her work which shall be shown in accordance with such forms and instructions as the department may approve.

(3) The remuneration paid to each worker for each pay period, showing separately:

(A) Money paid;
(B) Cash value of all other remuneration received from the employing unit;

(C) Special payments in cash or kind for services other than those rendered exclusively in a given pay period such as annual bonuses, gifts, prizes, etc., showing the nature of such payments and the period during which the services were performed for which such special payments were made.

(4) All disbursement records which show payments to anyone who performed services.

(5) Such other information as may be necessary to enable the employing unit to determine the worker's total remuneration earned in each week.

(b) Each employing unit which considers that it is not an employer subject to the code or that it is engaged in exempt employment shall keep and maintain the records required of such employing units under this regulation for at least eight years after the period to which the records relate.

(c) Each employer subject to the code shall keep and maintain the records required under this section for a period of at least four years after the date the contributions to which they relate become due, or the date the contributions are paid, whichever is the later.

(d) If an employing unit processes and maintains records in the form of magnetic media such as tapes or disks, then records include, but are not limited to, these magnetic devices or other machine sensible media.

(1) The procedures built into a computer's accounting program shall include a method of producing from punched cards, disks or tapes visible and legible records which will provide the necessary information for the verification of information required by this regulation.

(2) Magnetic media records which reflect payments for personal services shall be retained. Examples of such records include, but are not limited to, the following:

(A) Calendar year to date payroll master file.

(B) Vendor transaction history file.

(C) General ledger account distribution file.

(3) The records shall provide the opportunity to trace any transaction back to the original source or forward to a final total. The audit trail shall be designed so that the details underlying the summary accounting data, such as invoices and vouchers, may be identified and made available to the director upon request.
(4) A description of the electronic data processing portion of the accounting system shall be available. The statements and illustrations as to the scope of operations shall be sufficiently detailed to indicate (a) the application being performed, (b) the procedures employed in each application (which, for example, might be supported by flow charts, block diagrams or other satisfactory descriptions or input or output procedures), and (c) the controls used to insure accurate and reliable processing. Important changes, together with their effective dates, shall be noted in order to preserve an accurate chronological record.

(5) Substitution of hard copy records maintained or magnetic media do not meet the requirements of this section.

(6) If an employer engages an outside service bureau to process and maintain any of the records described in this section then it is the responsibility of the employer to meet the requirements of this section.

(e) In the event the records of an employing unit do not indicate the particular days during any week on which a worker performed services it shall be presumed, in the absence of evidence to the contrary, that the worker performed services on each day of such week.

The below statute is of standard applicability:

“Cal.Un.Ins.Code § 1088.5 Information reported on new employees; contents; failure to report; penalty; use of information

(a) In addition to information reported in accordance with Section 1088, effective July 1, 1998, each employer shall file, with the department, the information provided for in subdivision (b) on new employees.

(b) Each employer shall report the hiring of any employee who works in this state and to whom the employer anticipates paying wages.

(c)(1) This section shall not apply to any department, agency, or instrumentality of the United States.

(2) State agency employers shall not be required to report employees performing intelligence or counterintelligence functions, if the head of the agency has determined that reporting pursuant to this section would endanger the safety of the employee or compromise an ongoing investigation or intelligence mission.

(d)(1) Employers shall submit a report as described in paragraph (4) within 20 days of hiring any employee whom the employer is required to report pursuant to this section.

(2) Notwithstanding subdivision (a), employers transmitting reports magnetically or electronically shall submit the report by two monthly transmissions not less than 12 days no more than 16 days apart.
(3) For purposes of this section, an employer that has employees in two or more states and that transmits reports magnetically or electronically may designate one state in which the employer has employees to which the employer will transmit the report described in paragraph (4). Any employer that transmits reports pursuant to this paragraph shall notify the Secretary of Health and Human Services in writing as to which state the employer designates for the purpose of sending reports.

(4) The report shall contain the following:

(A) The name, address, and social security number of the employees.

(B) The employer's name, address, state employer identification number (if one has been issued), and identifying number assigned to the employer under § 6109 of the Internal Revenue code of 1986.

(C) The first date the employee worked.

(5) Employers may report pursuant to this section by submitting a copy of the employee's W_4 form, a form provided by the department, or any other hiring document transmitted by first class mail, magnetically, or electronically.

(e) For each failure to report the hiring of an employee, as required and within the time required by this section, unless the failure is due to good cause, the department may assess a penalty of twenty-four dollars ($24), or four hundred ninety dollars ($490) if the failure is the result of conspiracy between the employer and employee not to supply the required report or to supply a false or incomplete report.

(f) Information collected pursuant to this section may be used for the following purposes:

(1) Administration of this code.

(2) Locating individuals for purposes of establishing paternity and establishing, modifying, and enforcing child support obligations.

(3) Administration of employment security and workers' compensation programs.

(4) Providing employer or employee information to the Franchise Tax Board for the purpose of tax enforcement.

(5) Verification of eligibility of applicants for, or recipients of, the public assistance programs listed in § 132b-7(b) of Title 42 of the United States Code.
Employment Records

Please note that the above statutes apply only to “employers” with 5 or more employees pursuant to:


As used in this part in connection with unlawful practices, unless a different meaning clearly appears from the context:

(a) "Affirmative relief" or "prospective relief" includes the authority to order reinstatement of an employee, awards of back pay, reimbursement of out-of-pocket expenses, hiring, transfers, reassignments, grants of tenure, promotions, cease and desist orders, posting of notices, training of personnel, testing, expunging of records, reporting of records, and any other similar relief that is intended to correct unlawful practices under this part.

(b) "Age" refers to the chronological age of any individual who has reached his or her 40th birthday.

(c) "Employee" does not include any individual employed by his or her parents, spouse, or child, or any individual employed under a special license in a nonprofit sheltered workshop or rehabilitation facility.

(d) "Employer" includes any person regularly employing five or more persons, ...."

Once a claim for benefits (unemployment, disability, etc.) is made, then the record-keeping requirements change. If there is no issue that the person was an employee, then you must keep the records for at least 4 years from the time that the contributions are due or actually paid, whichever is the later. IF you contend that the person was not an employee (for example, an independent contractor), or if you otherwise claim that you are exempt, then you must keep the records for 8 years “after the period to which the records relate.”

WHAT ABOUT UNFAIR, HARASSMENT OR DISCRIMINATORY EMPLOYMENT PRACTICES CLAIMS?

There has been substantial publicity in recent years about the increase in lawsuits regarding claims of sexual or other workplace harassment. Many of you may offer insurance to provide defenses to businesses subject to such claims. Those same kinds of claims may be brought against you.

California state law includes what is broadly known as the “Unruh Civil Rights Act,” which provides for the award of a minimum “fine” of $4,000 per violation and for the award of attorneys’ fees to the victim, in addition to any compensatory damages proven. (see Civil Code sections 51, et seq.).
Often, the defense to claims of harassment or discrimination may be assisted by documentation in the personnel file, especially if the claimant is alleging some form of retaliatory termination. If the personnel file reflects other problems with that employee, it will be strong evidence that your attorneys may need to defend you.

Of course, this is true with regard to any form of lawsuit against you by an employee or even a prospective one. It is always possible that an applicant may accuse you of failing to hire them because of some invidious discrimination based upon race, sex, age, religion, or some other protected category, and your files regarding the actual applicants besides the claimant may be important to your defense.

So, your own protection and best interest would be to retain the records until there is no risk of such a claim. Thus, it would be advisable to retain your personnel files, including applications and resumes of even unsuccessful applicants for a minimum of 7 years, taking the 4 year statute of limitations for breach of written contract and adding 3 years for the maximum time to serve a lawsuit on the defendant once a suit has been filed. Given the possibility of an 8 year retention time period for unemployment claims (if you are claiming they were not an employee or that you are exempt), we recommend that you adopt a policy of retaining your employment records for 8 years from the time the employee (or applicant) is terminated, quits or is not hired.

The federal government prescribes a time frame of 180 days after alleged unlawful employment practice occurs to file a claim with the Commission of such practice. Thus, it would be advisable to maintain records of unfair employment practices for the duration of claimant’s employment, and even indefinitely thereafter in anticipation of litigation stemming from the unfair employment practice complained about.

“42 USC se 2000e-5

(b)Whenever a charge is filed by or on behalf of a person claiming to be aggrieved, or by a member of the Commission, alleging that an employer, employment agency, labor organization, or joint labor management committee controlling apprenticeship or other training or retraining, including on the job training programs, has engaged in an unlawful employment practice, the Commission shall serve a notice of the charge (including the date, place and circumstances of the alleged unlawful employment practice) on such employer, employment agency, labor organization, or joint labor management committee (hereinafter referred to as the "respondent") within ten days, and shall make an investigation thereof...

(e) Time for filing charges; time for service of notice of charge on respondent; filing of charge by Commission with State or local agency; seniority system

(1) A charge under this section shall be filed within one hundred and eighty days after the alleged unlawful employment practice occurred and notice of the charge (including the date, place and circumstances of the alleged unlawful employment practice) shall be served upon the person against whom such charge is made within ten days thereafter, except that in a case of an unlawful employment practice with respect to which the person aggrieved has initially instituted proceedings with a State or local...
agency with authority to grant or seek relief from such practice or to institute criminal
proceedings with respect thereto upon receiving notice thereof, such charge shall be filed
by or on behalf of the person aggrieved within three hundred days after the alleged
unlawful employment practice occurred, or within thirty days after receiving notice that
the State or local agency has terminated the proceedings under the State or local law,
whichever is earlier, and a copy of such charge shall be filed by the Commission with the
State or local agency...”

“42 USC §2000e-8

c) Every employer, employment agency, and labor organization subject to this
subchapter shall (1) make and keep such records relevant to the determinations of
whether unlawful employment practices have been or are being committed, (2) preserve
such records for such periods, and (3) make such reports there from as the Commission
shall prescribe by regulation or order, after public hearing, as reasonable, necessary, or
appropriate for the enforcement of this subchapter or the regulations or orders there
under.”

WHY DO YOU THINK IT IS POTENTIALLY IMPORTANT TO KEEP RECORDS
EVEN LONGER THAN 2 (OR 4 OR 8) YEARS?

After all this legal discussion (which we hope was not too boring), we have hopefully
shown you why it is legally important to maintain your files and records on any employee
or applicant for employment for at least 2 years, and even more if they make a claim for
benefits.

However, it is our strong suggestion that you consider the feasibility in your practice of
keeping records for even longer. To understand the potential importance to you in
keeping these records longer than required, we need to review some of the statute of
limitations issues and practical realities of California litigation.

First of all, your own protection suggests that you might want to keep your records for a
length of time well beyond the legal minimums. The unfortunate reality for any
employer is that your involvement in employment related claims may not occur until
many years after the transaction has faded from your memory, and possibly from your
records.

Depending upon its basis, a lawsuit against you for employment related matters may have
statutes of limitations of at least 4 years, if based upon the alleged breach of any written
contract. Many agents and brokers have written contracts of engagement, both for their
direct employees and for those they consider to be “independent contractors.” Often, such
written contracts include anti-competition clauses and trade secret protection, which is
the reason for many such contracts to come into existence. However, such a contract also
allows for a longer statute of limitations.

Even without the written contract, ordinary fraud claims are subject to a statute of
limitations of 3 years, generally from the date of the discovery of the fraud. So, an
employee who claims that you lured them away from their prior employment by making false promises may sue you for fraud.

Once a lawsuit is filed, the outside maximum for service of the lawsuit is three years, although courts have adopted rules designed to speed up that process. Even that time period would not be enough for a completely “bullet proof” retention policy, because it is possible to add you as a defendant or cross-defendant to a pending suit well after the filing of such a lawsuit.

Of course, that “cautious” approach is above and beyond the legal minimums. Remember, though, all it takes is one claim against you that you could have defended better with access to destroyed records to make the cost and bother of doing so more than worth it. Think of it as extra business insurance.

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(note about the author: Mr. Frederick has been a practicing litigation and coverage attorney since 1974. He has authored articles and chapters in texts on the subject of insurance coverage, and has represented insurance agents and brokers, as well as other professionals, as well as insurers in coverage matters. He has also represented numerous insureds and companies in general liability claims of all stripes. He has represented the Alliance of Insurance Agents and Brokers in a number of matters, including appearing on behalf of our organization as a friend of the court in matters of importance to our membership. He has also served as a speaker at our annual convention.)
SECTION C

Record Retention
PART I
RECORD RETENTION REGULATIONS FOR AGENTS AND BROKERS

Section C
Basic Tax Records Retention for Agents and Brokers

This article is the conclusion of a series of three articles addressing records retention requirements for agents and brokers. Our primary focus in this article will be on the legal requirements of the retention of records relating to taxes in general. Since tax records and records of payment to your employees are also generally part of their personnel records also, you should carefully read the second in this series of articles, which explains the record retention requirements for employment records. Where 2 possible time periods apply to a set of records, always follow the longer period. Tax and payroll compliance can make up as much as 80% of the regulatory burden faced by smaller employers. This is an area that is very sensitive with the IRS because the IRS considers it as an area where employers may withhold monies that do not belong to employers, and so any withholding must be fully substantiated. This article will offer some insight regarding compliance failures and highlight the basics in order to be compliant, and describe the potential penalties that may result if there is a failure of compliance in the payroll arena.

This article will also offer some discussion on retention of records relating to income tax and pension plans, which are other common issues a brokers and agents business may deal with.
## PRACTICE TIPS FOR RETAINING TAX RELATED RECORDS

<table>
<thead>
<tr>
<th>Types of Documents and Suggested Retention Periods:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee benefits plans, including ERISA, and 401 k for small businesses. (Employee Retirement Act Income Security)</td>
</tr>
<tr>
<td>Any records that would relate and/or substantiate withholding from an employee, which would include wage garnishments or any other type of monies withheld from the employee.</td>
</tr>
<tr>
<td>As to Income Tax Returns, Financial Statements, and any documents relating to establishing your business as a “corporation.”</td>
</tr>
<tr>
<td>8 years as we previously recommended for the retention of employment records, except for those records that should be kept permanently.</td>
</tr>
</tbody>
</table>

We provide a summary of typical documents involved in a small business concern and the suggested retention time period. Note the application of 6 years to most of the records, but again, a conservative retention policy for your business should be up to 8 years (with the exception of those records that should be kept permanently) since this retention period is also the amount of time which some statutes require for the retention of sensitive employment related records. You may as well have one set time period to keep the majority of the records to avoid having to remember how long to keep which records.
<table>
<thead>
<tr>
<th>DOCUMENT</th>
<th>PERIOD HELD IN YEARS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax returns, revenue agents reports, protests and court briefs and appeals.</td>
<td>Permanently</td>
</tr>
<tr>
<td><strong>FINANCIAL STATEMENTS:</strong></td>
<td></td>
</tr>
<tr>
<td>Annual statements</td>
<td>Permanently</td>
</tr>
<tr>
<td>Monthly statements for internal purposes</td>
<td>3 yrs minimum</td>
</tr>
<tr>
<td>Documents Substantiating Fixed Assets Additions</td>
<td>Permanently</td>
</tr>
<tr>
<td>including amounts and dates of additions or improvements, details related to retirements, depreciation policies and salvage value assigned to assets.</td>
<td></td>
</tr>
<tr>
<td><strong>PERSONNEL AND PAYROLL RECORDS:</strong></td>
<td></td>
</tr>
<tr>
<td>Assignments, attachments, and garnishments</td>
<td>6 yrs after settlement or termination</td>
</tr>
<tr>
<td>Employee compensation rate and deduction authorization</td>
<td>6 yrs after termination</td>
</tr>
<tr>
<td>Payments and reports for:</td>
<td></td>
</tr>
<tr>
<td>--federal income tax withholding</td>
<td>6 years</td>
</tr>
<tr>
<td>--FICA contributions</td>
<td>6 years</td>
</tr>
<tr>
<td>--unemployment taxes</td>
<td>6 years</td>
</tr>
<tr>
<td>--workmens compensation insurance</td>
<td>6 years</td>
</tr>
<tr>
<td>Accident reports, disability and sickness benefits records</td>
<td>6 years</td>
</tr>
</tbody>
</table>
Employment contracts and group insurance records       6 yrs after termination
Time cards or timesheets                               6 years
Unclaimed wage reports                                 6 years

If you have incorporated your business, we suggest the following records retention timeline:

**CORPORATE DOCUMENTS:**

- Certificate of incorporation: Permanently
- Corporate charter: Permanently
- Constitution and bylaws: Permanently
- Stock, stock transfers and stockholders reports: Permanently
- Plans and articles of liquidation or mergers with other companies: Permanently
- Minutes, and resolution of board of directors meetings: Permanently
- Retirement and pension records: Permanently
- Leases: 6 yrs after cancellation or termination

Even though the IRS requires that payroll tax records be made available upon “notice”, we suggest those records should be kept for at least 4 years to coincide with the time frame mandated by the Cal.Admin. Code § 1085-2 for unemployment benefits records. To provide added cushion, we suggest up to 6 years to allow time for employment related claims by employees, and as suggested in Part Two of these articles, up to 8 years to provide added cushion for potential unemployment benefit claims by independent contractors.

We suggest that income tax returns be kept permanently because the IRS Regulations require that the books or records be kept at all times available for inspection by authorized internal revenue officers or employees, and be retained so long as the contents thereof may become material in the administration of any internal revenue law. [Code of Federal Regulations § 1.6001-1(a)] Any memoranda, or any other documentation relating to the preparation of tax reporting forms should be kept that would support the numbers relating to the income tax returns because under the Regulations, taxpayers are required to keep such books or records as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return of such tax or information.
Required Payroll Tax Records Retention

To aid in the accurate preparation and verification of tax returns by the IRS, employers must keep prescribed records as to their employees and the wages paid them. Generally, these records should be kept for at least four years after the due date of such tax for the return period to which the records relate or the date such tax is paid, which ever is later. (Code of Federal Regulations, Tit.26 § 31.6001-2) This time frame should be adopted to be consistent with the time required under Cal.Admin.Code Tit.22, § 1085-2 for employee-related records. (Cal.Admin.Code Tit.22, § 1085-2, as discussed in our previous article on retention of employment related records, reference to “all” presumably includes related employment tax records which the Federal Regulations here specifically addresses.)

Record keeping requirements apply not only to employees hired directly by the employer but also to assistants or helpers who may have been hired by the employees. Since the employer is generally deemed to be the employer of the assistants or helpers (so long as the characteristics of an employer-employee relationship are present) for purposes of withholding, filing returns and furnishing required statements, the employer is also obligated to keep whatever records must retained for those assistants or helpers. Please note that to be completely careful, even if that person is deemed an independent contractor, you should retain the records of that person just as if they were an employee. Not only is this potentially important for tax purposes, but it may also be very important if it is necessary to establish that the person is, indeed, an independent contractor.

All employers who withhold federal income tax must retain and keep those records at convenient and safe locations accessible to IRS officers (26 C.F.R. § 1.6001-1), and make available for inspection by such officers records that indicate the following:

1. The name, address and social security number of each employee;
2. The total amount and date of each payment of cash or noncash remuneration (including any amounts withheld as tax or for any other reason) and the period of service covered by the payment;
3. The amount of remuneration indicated in (2) that constitutes wages subject to federal income tax withholding;
4. The amount of tax withheld from wages subject to withholding and if withheld at a time other than the time the payment was made, the date it was withheld;
5. If the total remuneration indicated in (3) and the remuneration subject to withholding indicated in (4) are not equal, the reason for the inequality;
6. Copies of statements received from nonresident individuals with respect to their citizenship;
7. Copies of any statements furnished by an employee relating to residence or physical presence in a foreign country;

8. The fair market value and date of each payment of non-cash remuneration paid to an employee for services.

9. Any agreement between the employer and the employee for the withholding of additional amounts of tax.

Of course, before concerning oneself with maintaining those records listed above, you must first and foremost define the employer/employee relationship.

Complex rules and definitions underlying the federal payroll tax statutes make it difficult to establish procedures to ensure that your business complies with all applicable rules and requirements. We suggest the following seven-step approach to payroll tax compliance and related documents generated in order to substantiate withholdings/deductions. Each step identifies a critical task your business must complete to successfully discharge its payroll tax responsibility.

1. **Determine Worker Classification.** A worker can either be an employee of the business or an independent contractor (i.e., a self-employed businessperson). While the business is liable for payroll taxes on wages paid to an employee, it is not liable for payroll taxes on amounts paid to an independent contractor. Hence, worker classification is the most critical step in establishing the potential payroll tax obligation for each worker.

2. **Establish Employer Liability for Payroll Taxes.** The starting point in the process is to determine whether the person [broadly defined in IRC Sec. 7701(a)(1) to include individuals, associations, corporations, companies, partnerships, trusts, and estates] who is making wage-type payments to a worker, or group of workers, is an employer of those workers. If so, the person must comply with certain payroll tax duties.

3. **Determine Taxable Compensation.** The amount of employment taxes the employer should withhold and/or pay over to the IRS is calculated by multiplying the appropriate payroll tax rate by the amount of taxable compensation (i.e., wages). Each federal payroll tax statute has its own definition of what makes up the taxable wage base. Thus, the employer must separately compute (a) taxable wages reported on Form W-2 (FIT), (b) taxable wages subject to income tax withholding (FITW), (c) taxable wages subject to social security and Medicare taxes (FICA), and (d) taxable wages subject to federal unemployment tax (FUTA).

4. **Withhold FITW and FICA.** To calculate the amount of income tax to withhold, the employer must have a properly completed Form W-4 on file for each employee. The employer uses information appearing on the employee's Form W-4 to determine the amount to withhold, using one of several different methods. The most common methods are the wage bracket method and the percentage method. However, additional withholding methods are available in certain situations, such as in wage garnishments and assignments.
5. **Deposit Employee and Employer Payroll Taxes.** Employers accumulate four kinds of federal payroll taxes: (a) withheld income taxes, (b) withheld FICA taxes, (c) the employer's share of FICA taxes, and (d) the employer's FUTA taxes. Income taxes, and the employee and employer portions of the FICA tax, generally must be deposited on a monthly or semiweekly deposit basis. (An employer with an accumulated liability of $100,000 or more may be subject to a special one-day deposit rule). An employer's deposit status (monthly or semiweekly) for these taxes is determined by the total taxes reported in a four-quarter lookback period. The employer's FUTA taxes are subject to separate deposit rules and requirements.

6. **File Quarterly Payroll Returns.** Form 941 reports income tax withholding and FICA taxes (employee and employer share) on payroll-related items such as wages, supplemental unemployment benefits, and sick pay paid to employees. Most business employers must file Form 941 on a quarterly basis.

7. **File Annual Payroll Returns, Wage Statements, and Other Information Returns.** Form 943 reports income tax withholding and FICA taxes (both employee and employer share). Form 945 reports income tax withholding, including backup withholding, on nonpayroll payments. Form 940 reports the employer's FUTA taxes on wages paid to business employees. All four of these returns are filed annually on a calendar year basis.

Businesses may have reporting obligations for various types of payments made to nonemployees as well. These can include interest and dividend payments, which are reported on Forms 1099-INT and 1099-DIV, respectively. Nonemployee (independent contractor) compensation is reported on Form 1099-MISC. Be sure that you performed the **most critical** step we recommend– that is, be sure that you have properly defined the employer/employee relationship before it begins. If there is any ambiguity or vagueness in that relationship, you will be inviting the IRS to review your books and may be responsible for back withholdings.

Failure to properly withhold and pay the employee/employer’s share of payroll taxes may result in steep penalties which we now discuss below.

**Penalties due to Failure to File or Failure to Pay**

A civil penalty may be imposed if a taxpayer does not timely file a tax return on which tax is due. [I.R.C. § 6651] This penalty—commonly referred to as the delinquency or failure to file (FTF) penalty—applies to most tax returns that are either filed late or not at all. However, the FTF penalty does not apply if the taxpayer establishes the failure was due to reasonable cause and not willful neglect. Different penalties for the failure to furnish either the IRS or the payee with a required information return (e.g., Form W-2 or 1099). [I.R.C. §§ 6721 and 6722]
A civil penalty is also imposed if a taxpayer does not timely pay tax that is due. \[\text{I.R.C. § 6651}\] This failure to pay (FTP) penalty has two components—the failure to pay tax shown as due on a return on the date prescribed for payment [\text{I.R.C. § 6651(a)(2)}], and the failure to pay tax within 21 calendar days (10 business days if the amount demanded is $100,000 or more) of the date of notice and demand for the tax [\text{I.R.C. § 6651(a)(3)}]. The first component can apply to the late payment of tax shown as due on an employment tax return, while the latter can apply to deficiencies resulting from an examination of an employment tax return or a mathematical error on the return. As with the failure to file penalty, the FTP penalty \textbf{does not} apply if the failure was due to reasonable cause and not willful neglect.

The FTP penalty equals half of 1% (0.5%) of the net tax shown on the return for each month or fraction of a month the tax remains unpaid, up to a maximum of 25%. The penalties for failure to pay tax shown on the return and failure to pay following notice and demand are both increased from 0.5% to 1% per month (subject to the same 25% maximum) after the IRS issues a notice of levy.

Clearly, you can be penalized up to 1/4 of your payroll tax debt for failing to timely pay the government what you withheld, or failed to withhold, from your employee. This penalty can be quite heavy to absorb by a small business owner especially if the failure in compliance was found to occur over more than one tax period.

\textbf{OTHER TYPICAL CATEGORIES OF RECORDS RETENTION FOR A BUSINESS}

\textbf{Employee Retirement Income Security Act (ERISA)}

The Employee Retirement Income Security Act demands extensive reporting and record keeping, and compliance has become increasingly expensive. Audits in the ERISA arena are inevitable; therefore, reporting and record keeping need to be planned and constructed under that assumption. ERISA audits are not a matter of "if", but "when."

Most of the records necessary for ERISA reporting are already being compiled for other purposes, primarily for the effective operation of the benefit plans involved, such as the 401k plan or profit sharing plan of your business. We suggest that at the minimum these records be kept for 6 years (for employees) to coincide with the retention of payroll related records.

Particular care should be taken when outside firms provide extensive guidance to a company in the ERISA area, since they are not required to maintain the supporting records for this advice and guidance. There is great potential for the records retention requirements to "fall through the cracks" and be ignored by the company employees who are responsible for records retention for many other purposes, but for shorter retention periods. With a properly implemented records retention policy as suggested above, however, these shortcomings can be avoided in this very complicated area.
(Note about the author: Mr. Frederick has been a practicing litigation and coverage attorney since 1974. He has authored articles and chapters in texts on the subject of insurance coverage, and has represented insurance agents and brokers, as well as other professionals, as well as insurers in coverage matters. He has also represented numerous insureds and companies in general liability claims of all stripes. He has represented the The Alliance of Insurance Agents and Brokers in a number of matters, including appearing on behalf of our organization as a friend of the court in matters of importance to our membership. He has also served as a speaker at our annual convention.)