

September 23, 2010

**New York State Alleges that Investors in Limited Liability Companies
May Face Unlimited Liability for Unpaid Sales Taxes**

To our clients and friends:

In a recent decision by the New York State Tax Appeals Tribunal, the New York State Division of Taxation successfully asserted that a member of a limited liability company (an “LLC”) that owes unpaid sales taxes to the State of New York can be held personally liable for the full amount of such unpaid sales taxes merely by being a member of such LLC. Under the reasoning of this decision, investors in LLCs, limited partnerships or limited liability partnerships could be saddled with unexpected liabilities well in excess of the amount they invested.

In this decision (In the Matter of the Petition of Joseph P. Santo, DTA No. 821797 issued December 23, 2009), the taxpayer (Mr. Santo) was a member of an LLC formed to operate a restaurant in New York State. Mr. Santo was given some managerial responsibility under the LLC’s operating agreement, and Mr. Santo’s role in the business was to run the day to day operations of the business because of his previous experience in the restaurant industry. However, responsibility for tax filings was delegated to a member of the LLC other than Mr. Santo. While Mr. Santo did not initially make any monetary investment in the LLC, his friends and family invested over \$900,000 and he later loaned the LLC the sum of \$15,000 (which was the extent of his savings) to cover payroll, which was never repaid. An audit notice was issued to Mr. Santo in May 2006 assessing liability for unpaid sales taxes (plus penalties and interest) attributable to the LLC of over \$180,000 which the Tax Division was holding Mr. Santo personally liable for as a member of the LLC. In the fall of 2006 bankruptcy proceedings on behalf of the LLC were commenced and the restaurant closed.

The Tax Division prevailed based on a literal reading of the New York State sales tax law. Section 1131(1) of the sales tax law defines “persons required to collect sales tax” to include not only vendor entities but also certain officers, employees and managers of such entities and **“any member of a partnership or limited liability company.”** An initial hearing officer found that Santo was not in the class of managers liable for sales tax because he had no control over tax filings. The Tax Appeals Tribunal overruled the hearing officer and stated that “[s]ince Tax Law § 1131(1) imposes **strict liability** upon members of a partnership or limited liability company, all that is required to be shown by the Division for liability to obtain is the person’s status as a member.” (The emphasis is ours.) There is no similar rule for investors in corporations, and such investors face liability only if they are responsible officers, managers or employees.

The Tax Division’s aggressive, taxpayer-unfriendly position is inconsistent with LLC laws limiting member liability to such member’s investment in the LLC. Unless future case law overrules this decision or the law at issue is changed (and we understand legislation to change law the may have been proposed but not yet adopted), investors should assume the Tax Division will continue to assert this position. To reduce the risk of investor liability, investors in LLCs with sales tax exposure in New York State should consider requiring such companies to undergo rigorous self-audits to ensure sales taxes are being properly paid or to convert such LLCs to corporations. We are happy to assist you in tailoring possible solutions to your particular facts.

If you have questions or would like additional information regarding the information discussed in this Client Alert, please contact Douglas Ellenoff (ellenoff@egsllp.com), Barry Grossman (bigrossman@egsllp.com), Peter Guy (pguy@egsllp.com), or the attorney with whom you regularly work.

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