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Sales and Use Tax Liability May Pierce the LLC/Limited Partnership Veil in New York

Assume that you are a truly passive investor in a limited liability company or a partnership. The company is not doing well. You have begrudgingly accepted that your equity is likely worthless, but at least you are not responsible for the company's liabilities. If the company has failed to pay sales or use taxes in New York then, unfortunately, you need to think again.

For many years, the prevailing view was that only a "responsible person" could be held personally liable for the failure of a limited liability company or limited partnership to remit New York State sales or use taxes. Cases looked at a number of factors such as whether the person had the authority to write checks on the company's behalf or to hire and fire employees, did the person have the power to exercise tax collection responsibilities, and what was the individual's knowledge of and control over the financial affairs of the company generally. The New York State Department of Taxation seemed to accept this view.

However, the New York State Department of Finance and Taxation appears to have adopted a new position. It has been reported that field auditors are now asserting that each member of a limited liability company (and each partner of a partnership) is potentially liable for a company's failure to remit New York State sales or use taxes, regardless of how passive the member's role in the company may have been. According to the Department of Finance and Taxation, all that is needed to impose liability on an individual or a company is its status as a member (or partner). Unfortunately, a literal reading of the applicable New York State Tax Law supports this view.

Some have argued that such a "new" interpretation is constitutionally flawed. Others say it is clearly inconsistent with the legislative intent of the laws that created limited liability companies and limited partnerships. Nonetheless, until greater clarity is provided by courts or the legislature, members of LLCs, and partners in limited partnerships, doing business in the State of New York should take precautions to avoid potential liability.

For those of us who work in the real estate world, most of the time this will not be a major issue for assets such as an office building. However, for a hotel or similar operating business, sales or use taxes may be quite significant and the potential liability to members should not be treated lightly.

It is beyond the scope of this Plain & Simple to delve into possible solutions to this problem. The purpose here is to alert all of us to this potential risk so it can be boxed as best as possible. If you have any questions or would like to discuss this issue further, please contact Bruce Stachenfeld at bstachenfeld@dslip.com.

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