

NYS Sales Tax: A Personal Liability Trap And A Limited Safe Harbor

Although limited partners and LLC members are generally not personally liable for the debts of an entity, New York law provides that (unlike shareholders of a corporation) limited partners and LLC members are personally liable jointly and severally for any sales tax deficiencies of the entity. Thus, under the statute, if an LLC or limited partnership does not pay all of its sales taxes, a member or limited partner, as applicable, could be personally liable for 100% of the deficiency. This liability exists even if the entity is not a New York entity. For example members of a Delaware LLC owing a NY State sales tax deficiency would be liable to NY State. NY State has also left unclear its ability to look through "stacked" entities.

Recognizing that such liability may impose an unfair burden on investors, who by law or contract, may have only limited, if any, control over the companies in which they invest, the Department of Taxation and Finance has set forth a new administrative policy that eliminates or greatly reduces sales tax exposure for investors in limited partnerships or LLCs.

Under the new policy set forth in TSB-M-11(17)(S), a limited partner's or member's exposure for unpaid New York sales tax will generally be based on his percentage interest in the company, unless in the case of a member of an LLC the member has a 50 percent or greater percentage interest in capital or profits of the company or has such responsibilities and powers of management or oversight with respect to the LLC that he would be a "responsible person". For example, the exposure of a limited partner with a 4 percent interest in capital and profits of a limited partnership for unpaid sales taxes would generally be limited to 4 percent of such deficiency, after reduction of the deficiency for any payments by the partnership or traditional "responsible persons".

The administrative relief is conditioned on the investor cooperating with New York by providing any information the State may request to identify persons who would be "responsible persons" for sales tax collection.

Besides being aware of the potential liability, and evaluating the risk in deciding what type of entity to form, limited partners and LLC members should include clear provisions in the operative documents allocating responsibility and providing, if applicable, for contribution and indemnity in connection with any sales tax liability.

If you have any questions regarding the new policy or the sale tax exposure of partners and members in New York generally, please contact [Steven Glaser](mailto:sglaser@mosessinger.com) at 212.554.7820, sglaser@mosessinger.com or [Howard R. Herman](mailto:hherman@mosessinger.com) at 212.554.7847, hherman@mosessinger.com.

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