

Client Alert

January 2015

NY Sales Tax Hits Passive Investors in Limited Partnerships and Limited Liability Companies

Next time you think about investing some “play” money in your friend’s trendy new restaurant, make sure you know what you’re getting into. If you’re not careful, you could find yourself on the hook for much more than you bargained for.

Under New York sales tax law, a passive investor (*i.e.*, a limited partner or non-managing member) in a limited partnership or limited liability company can be held personally liable for unpaid sales tax, even if the investor has no management authority or financial oversight responsibility. To make matters worse, New York State can choose to pursue only “deep pocket” members or limited partners for the entire unpaid sales tax. However, in his or her defense, a passive investor can limit (but not eliminate) the sales tax exposure to the investor’s pro rata share of the unpaid sales tax (based on relative profit/loss sharing percentages), pay interest at a lower rate on the reduced balance, and escape underpayment penalties, if the investor agrees to cooperate by providing information about other potentially liable persons and if the investor can show that the investor assumed no tax compliance duties with respect to the business and, in the case of a limited liability company, owns less than 50 percent of the limited liability company. While a targeted investor might be able to seek indemnification from the business, management and the other investors, the indemnification claim often has little or no value, given the time and cost involved in pursuing the claim and the fact that sales tax troubles are frequent by-products of unsuccessful or cash-strapped businesses.

Assessing and protecting against risk thus takes on added importance when investing in a limited partnership or limited liability company, as any investment, no matter how small, can produce personal sales tax liability far in excess of the dollar amount invested. So take the time to ask a few basic questions. Is the company in a retail, restaurant or other business where collecting sales tax from customers is a fact of life? Is the company adequately capitalized, especially in terms of working capital? Does management have sufficient experience in sales tax compliance? Does the

attorneys

Mark A. Limardo
mlimardo@olshanlaw.com
212.451.2364

Eric Homsi
ehoms@olshanlaw.com
212.451.2242

practice

Tax & Personal Planning

limited partnership agreement or limited liability company agreement include adequate financial controls, indemnification rights and other safeguards, especially for minority investors? Are other asset protection structures available as a shield against personal liability for sales tax?

A little prevention at the start will keep you from ending up like the two unlucky minority investors in the recent *Boissiere* case, who probably thought owning part of a nightclub was fun until they got stuck with the sales tax bill when the nightclub went out of business.

For more information on this topic, please contact the Olshan attorney with whom you regularly work or either of the attorneys listed below.

attorneys

Mark A. Limardo
mlimardo@olshanlaw.com
212.451.2364

Eric Homsi
ehoms@olshanlaw.com
212.451.2242

practice

Tax & Personal Planning

This publication is issued by Olshan Frome Wolosky LLP for informational purposes only and does not constitute legal advice or establish an attorney-client relationship. In some jurisdictions, this publication may be considered attorney advertising.

Copyright © 2014 Olshan Frome Wolosky LLP. All Rights Reserved.