

# Responsible Person Assessments in New York State: What You Don't Realize Might Hurt You

*By Yvonne R. Cort, Esq., Partner at Capell Barnett Matalon & Schoenfeld LLP*

Your business has financial problems and you find a lender to save the day. Sometime later, the lender declares a default, funds are put in a lockbox and you have no control of how the monies can be spent. The business stops paying sales tax. Can New York State come after your personal assets to collect the company's unpaid sales tax? According to current case law, and as reflected in a recent Administrative Law Judge determination, you could be personally liable for tax, interest and penalties, for failing to safeguard the monies for the State.



*Yvonne R. Cort, Esq.*

the company. The burden of proof is on the individual to show by clear and convincing evidence that he was not a person under a duty to collect tax within the meaning of the law, and therefore should not be assessed as a responsible person.

## Not in Control of Finances? You Still Might Be Held Responsible

Sometimes, lack of authority and control is not enough. In *Matter of Kieran* (DTA No. 823608, N.Y.S. Tax App. Trib. 2014), Patrick Kieran was held to be personally liable for

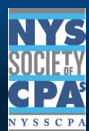
unpaid sales tax, even though he had no control over the relevant funds at the time the taxes were due. Mr. Kieran was the president of a car dealership and entered into a financing agreement on behalf of the company. The dealership defaulted; and pursuant to the agreement, the financing company, GMAC, "swept" the dealership's bank account, taking funds including sales tax collected from customers. GMAC applied the monies to pay down its own loan to the dealership rather than remit sales tax to the State.

The NYS Tax Appeals Tribunal held that Mr. Kieran was still responsible during the audit period, as president of the company and in charge of day-to-day management. In addition, he failed in his duty as a responsible person when the company agreed to the sweep provision. The Tribunal emphasized that the business voluntarily entered into the GMAC agreement and the outcome was foreseeable.

## Who is Responsible?

Sales tax is considered a trust tax: the business collects the tax for the NYS Dept. of Taxation and Finance, and holds it in trust until it is remitted to the State. New York tax law imposes personal liability on any person required to collect sales tax on behalf of a business. Whether a person is responsible in the meaning of the law depends on the facts and circumstances of each case.

In general, the law imposes responsibility on those who have authority and control in the company. The person's position in the company is not determinative; individuals required to collect the tax may be corporate officers or directors, or employees with a duty to act for the company. Other relevant factors include whether the individual had check signing authority, authority to sign sales tax returns, ability to hire and fire employees, or involvement in the day-to-day management of



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## Look at the Specific Facts

When it comes to responsible person assessments, it's particularly important to examine the specific aspects of each situation. In *Matter of Kieran*, the Tribunal indicated that the result might be different if the dealership had not created their own problem by choosing to enter into the agreement. Significantly, the financing agreement was not put into evidence, so there was no proof that GMAC had legal control of the funds, or that Mr. Kieran was unable to take corrective steps such as rescinding the agreement.

## Recent ALJ Determination: For These Taxpayers, No Access to Funds is Not an Excuse

A recent Administrative Law Judge determination applied the *Kieran* reasoning to minority members of a limited liability company. (Note that ALJ determinations cannot be considered as precedent.) In *Matter of Henrie*, (DTA No. 825871, ALJ 2016), two members of a LLC argued that they should not be personally liable for over \$700,000 of unpaid sales tax, interest and penalties. The LLC's related business, a hotel, had been "seized" by a third party when financial problems arose. Pursuant to the terms of financing and related agreements, hotel revenue was put in a lockbox to which the LLC had no access. The members creatively argued that since the LLC had no financial control of the hotel during the relevant period, the LLC did not have an obligation to pay the tax, and neither did the members.

The members were in a difficult position because, unlike individuals involved with most other types of entities, New York State law imposes personal liability for sales tax on all members of a LLC, regardless of the factors showing a duty to act. If a minority member of a LLC can show lack of involvement in the company,

the State may apply a policy allowing partial relief (TSB-M-11(6)S).

The Administrative Law Judge determined that the LLC voluntarily entered into the arrangement that led to the takeover by the third party; and the situation was foreseeable. Therefore, the LLC cannot avoid responsibility for collecting sales tax, and the members were responsible persons under the law. Moreover, because they created the situation that led to the nonpayment of tax, they were derelict in their duties as responsible persons, and liable for penalties. Not surprisingly, the ALJ also held that the State's mitigating policy did not apply to these members.

## Conclusion

As these recent cases show, whether an individual is personally liable for sales tax may depend on business decisions taken for reasons unrelated to the payment of sales tax. It's important for taxpayers and tax professionals to recognize the foreseeable consequences of business actions and to consider taking steps to protect the individuals as well as the business.

*Yvonne R. Cort, Esq., focuses her practice on the resolution of IRS and NYS tax controversies. She is a partner with the law firm of Capell, Barnett Matalon & Schoenfeld LLP, with offices in Jericho, NY and New York City. She can be reached at [ycort@cbmslaw.com](mailto:ycort@cbmslaw.com)*