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Are Members of an LLC Personally Liable for Their LLC's Sales and Payroll Taxes?



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Chief Administrative Law Judge Bill Thompson recently affirmed his 2010 ruling that the individual members of a multi-member LLC are not personally liable for withholding (payroll) or sales taxes owed by the LLC, unless they qualify as "responsible persons" under the state's 100% penalty statute. That issue remains critically important to investors in LLCs that operate in Alabama. *Box Family Restaurants, LLC v. State Department of Revenue*, Admin. Law Div. Dkt. No. S. 11-375 (Prelim. Order on Taxpayer's Appl. for Reh'g June 28, 2011).

In this new ruling, Judge Thompson initially dismissed the appeal because the LLC member's notice of appeal was not filed within 30 days after entry of the final assessment. The member timely applied for rehearing and argued that he did not receive the final assessment until well after the mandatory 30 day appeal period had expired. He subsequently appealed within 30 days from his receipt of the final assessment, arguing that he had never been actively involved in his son's business. Judge Thompson ordered the Alabama Department of Revenue (the "Department") to notify the Administrative Law Division whether it properly mailed the final assessment at issue to the member's last known address (vs. the LLC's last known address) by certified mail.

Obviously, there could be a Due Process issue here. If the Department failed to notify the member properly, the Judge stated that the Administrative Law Division would reinstate the appeal on its docket but then hold the case in abeyance pending a final decision in *Nonna Rose Kingsley LLC*, which has been pending in Jefferson County Circuit Court for over 15 months now, with no trial date set.

Readers may recall that *Kingsley* – like *Box Family* – involved final assessments entered against both the restaurant LLC and its members, the amount of which was not contested. The only issue was whether a local physician, Dr. John Kingsley, was personally liable for the tax as a 25% and passive member. In *Bayside Tire & Exhaust, LLC v. State Department of Revenue*, Judge Thompson held that the individual members of a multi-member LLC that was taxed as a partnership for federal and Alabama income tax purposes were jointly and severally liable for the LLC's payroll withholding obligations, based on a provision in the Alabama LLC Act that conforms Alabama tax law to the federal entity classification rules. Admin. Law Div. Dkt. No. W. 98-272 (Oct. 13, 1998).

The taxpayer successfully argued in *Kingsley* that *Bayside* was incorrectly decided because of the different state law liability obligations imposed on members of an LLC versus general partners. Additionally, the taxpayer cited the Internal Revenue Service's position with respect to federal employment taxes that "if under state law the members of an LLC are not liable for the debts of the LLC, then absent fraudulent transfers or other special circumstances, the IRS may not collect the LLC's employment tax liability [directly] from the members..." Rev. Rul. 2004-41, 2004-18 I.R.B. 845.

Because the Alabama LLC Act provides that members of an LLC are not personally liable for the debts of the LLC, unlike general partners of a partnership, Judge Thompson agreed with the taxpayers in *Kingsley* and held that *Bayside* had been incorrectly decided. "[C]onsistent with the IRS' position on the issue, LLC members cannot be held personally liable for any [Alabama] taxes owned by the LLC," such as withholding, sales and use, and other non-income taxes. However, "as under federal law, the members may, under the appropriate circumstances, be held personally liable for any trust fund taxes under Alabama's [responsible person penalty statute]."

Judge Thompson's holdings in *Kingsley* and *Box Family* illustrate the well-established principle that when Alabama's taxing provisions are modeled after or adopted from federal provisions, such as the classification of LLCs for purposes of taxation, the IRS' guidelines with respect to that provision should also be followed. See Ala. Code § 40-18-1.1(b); *Ex parte Jones Mfg. Co., Inc.*, 589 So. 2d 208 (Ala. 1991).

The authors expect the Alabama Legislature to address this issue next Spring since Judge Thompson is holding a number of similar cases in abeyance pending the outcome of the *Kingsley* appeal, and the ADOR has not changed its position. The authors are members of a Task Force commissioned by the Alabama State Bar Tax Section to study this issue as well as several others involving the manner in which LLCs and other Subchapter K entities are taxed for purposes of sales, use, rental, property, excise, etc. taxes. For example, should a single member LLC be disregarded for purposes of all these taxes or solely for income and financial institution excise taxes? Jimmy Long was the principal author of an article published last year in *The Alabama Lawyer* on these issues. A copy of that article is available on our SALT Practice Group's website at <http://www.babc.com/files/Publication/dd85c2ce-7ea0-4a4e-b424-4a5cbe02dcb5/Presentation/PublicationAttachment/844ce9da-18e4-471b-8cac-387d9df2fc81/AL%20Lawyer%20Article.pdf>.

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