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March 17, 2006

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Albany, NY 12247

Herman D. Farrell, Jr.
Chair, Ways and Means Committee
New York State Assembly
Legislative Office Building, Room 923
Albany, NY 12247

Dear Sirs:

We are writing to urge the Legislature to enact legislation to amend Section 1131(1) of the New York State Tax Law. As currently written, Section 1131(1) imposes personal liability on all limited partners and all members of limited liability companies ("LLCs") for any unpaid sales taxes of such entities, even if the limited partner or LLC member is a passive investor having no role in the operation of the entity's business. We believe that personal liability should be imposed only on those persons who bear responsibility for the default in payment, and urge you to amend Section 1131(1) so to provide. The Tax Section has discussed amendment of Section 1131(1) with the New York State Department of Taxation and Finance (the "Department") and has been advised that the Department does not oppose the Section's recommendation that the statute be corrected by legislation.

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This proposed legislative change would conform the personal liability provisions of the sales tax to the analogous personal liability provisions of New York State Tax Law Section 685(g), which imposes personal liability for unpaid withholding taxes of a business. This change would eliminate a disparity in the collection of trust fund taxes¹ for which there is no known policy or legislative basis. If not corrected, Section 1131(1) exposes mere passive investors in LLCs and limited partnerships to personal liability for unpaid sales taxes of a business. The personal exposure of passive investors to a potentially significant liability due to circumstances beyond their control is not just grossly unfair; it could deter investment in New York State businesses.

In July 2003, the Tax Section submitted to the Commissioner and the Executive Deputy Commissioner of the Department the enclosed report on Section 1131(1) (the "Report"). As is discussed in detail in the Report, New York imposes personal liability on an individual for a corporation's failure to collect or pay trust fund taxes only if the individual is found to be a "responsible person;" that is, a person who had responsibility for the default in the collection or payment of the taxes. This rule is also applied to LLC members and limited partners for unpaid withholding taxes, both in New York and under Section 6672 of the federal Internal Revenue Code. In the case of a general partnership or sole proprietorship, the government can look to collect from the general partners or owner because, under state law, such persons have personal liability for the debts of the business. The "responsible person" concept has been followed by federal and state taxing authorities for many years and, as a result, there is a substantial body of case law and regulations providing guidance to taxpayers concerning who is a "responsible person."

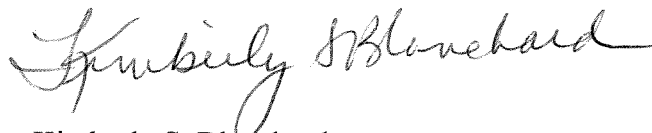
In contrast, as currently written, Section 1131(1) appears on its face to impose absolute liability for unpaid sales taxes on all members of an LLC and on all limited partners of a limited partnership, without regard to whether the member or limited partner had an active role or significant involvement in the financial affairs or management of the business. The absolute liability imposed by Section 1131(1) is in direct conflict with other provisions of New York law intended to encourage investment in LLCs and limited partnerships. Section 609(a) of the New York Limited Liability Company Law provides that members of an LLC will not be liable for the debts of the LLC "solely by reason of being such member." Section 121-303 of the New York Partnership Law similarly insulates limited partners from the debts of a partnership. Given the current statutory language of Section 1131(1), the Department would appear to have the power to contravene the intent of these limitation of liability provisions by pursuing an assessment for unpaid sales taxes against a mere passive investor in an LLC or limited partnership.

¹ "Trust fund taxes" are taxes imposed on a person other than the person required to collect, account for and pay over the taxes to the government. Examples of trust fund taxes are federal and state withholding taxes required to be withheld by an employer from the employee's wages and sales taxes required to be withheld by a vendor from a purchaser. Since the obligation for payment of the sales tax is imposed on the purchaser, the vendor acts as a fiduciary in collecting and paying over the sales tax to the state on behalf of the purchaser.

The Tax Section recommends that members of LLCs and limited partners in partnerships who are mere passive investors and who bear no responsibility for the default in collection or payment of the sales taxes of the business not have absolute liability for the tax. Section 1131(1) should be amended to conform to the trust fund liability provisions of New York State Tax Law Section 685(g) and Internal Revenue Code Section 6672. This amendment will allow the responsible person concept to be applied uniformly to the determination of who is responsible for unpaid trust fund taxes owed by a business, without regard to the type of tax (sales or withholding tax) or the form of the business entity. Page 16 of the enclosed report contains language for a proposed amendment to Section 1131(1) as well as alternative suggestions.

We welcome the opportunity to work with you, your staffs and the Department on this proposed legislation.

Respectfully submitted,



Kimberly S. Blanchard
Chair

cc: Joseph L. Bruno, Temporary President and Majority Leader
James Tedisco, Assembly Minority Leader
Commissioner Andrew S. Eristoff
First Deputy Commissioner Barbara G. Billet
Deputy Commissioner Christopher O'Brien
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