

NONNA ROSE KINGSLEY, LLC,	§	STATE OF ALABAMA
d/b/a NONNA ROSE KINGSLEY, LLC,		DEPARTMENT OF REVENUE
AND ITS MEMBERS, JOHN R.	§	ADMINISTRATIVE LAW DIVISION
KINGSLEY, JAMEY FRAZIER, AND		
ROBERT L. BURTON	§	
700 MONTGOMERY HWY.		
BIRMINGHAM, AL 35216-1869,	§	DOCKET NO. W. 09-1194
Taxpayer,	§	
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

FINAL ORDER

The Revenue Department assessed Nonna Rose Kingsley, LLC, and its members, John R. Kingsley, Jamey Frazier, and Robert Burton, for withholding tax for the month 1/2008, and the quarters ending 3/31/2008 and 6/30/2008. John R. Kingsley ("Taxpayer") appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on April 1, 2010. The Taxpayer's representatives, David Anderson and Deanna Weidner, attended the hearing. Assistant Counsel Mark Griffin represented the Department.

The Taxpayer in this case does not dispute the amount of the final assessment in issue. Rather, he claims that as a LLC member only, he should not be held personally liable for the withholding taxes owed by the LLC. He also argues that he only invested in the business and was not actively involved in operating the business.

The Taxpayer is a practicing physician in Birmingham, Alabama. He was approached by various individuals about opening a new restaurant in Birmingham. The parties agreed that the Taxpayer would finance the business, and that the other individuals would operate the restaurant. The parties also agreed to own and operate the business

through a limited liability company, or LLC. The Taxpayer, as a member, owned 25 percent of the LLC.

The restaurant eventually closed. It failed to pay its Alabama withholding tax liabilities for the periods in issue. The Department subsequently entered the final assessment in issue against the LLC and its members, individually, for the tax, penalties and interest due. This appeal followed.

This case turns on whether a member of an LLC is individually liable for the non-income Alabama taxes owed by the LLC. That issue was previously addressed by the Administrative Law Division in *Capitol Machine & Equipment Co., LLC, and its members Sun Enterprises, LLC, and Robert W. Shiver v. State of Alabama*, S. 08-619 (Admin. Law Div. 4/20/2009). The Administrative Law Division held in that case that members of an LLC were not personally liable for the non-income taxes of an LLC, as follows:

Issue (3). The Liability of the LLC Members.

In *Bayside Tire & Exhaust, LLC v. State of Alabama*, W. 98-272 (Admin. Law Div. 10/13/1998), the Administrative Law Division held that the members of a multi-member LLC that had not elected to be taxed as a corporation were individually liable for the withholding tax owed by the LLC. The Taxpayer in this case argues that *Bayside Tire* was incorrectly decided. The Taxpayer's brief on the issue reads as follows:

The Taxpayer believes that the Department incorrectly included the Taxpayer's members, Sun Enterprises, LLC and Robert W. Shiver (collectively, the "Members"), in its assessment. The Taxpayer is a limited liability company organized under the laws of the State of Alabama. Under Alabama law, ". . . a member of a limited liability company is not liable under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the limited liability company, whether arising in contract, tort, or otherwise . . ." Code of Alabama, 1975 section 10-12-20(a). The Taxpayer acknowledges that the Administrative Law Judge has previously held that members of a limited liability company may

be individually liable for the tax debts of the company. See Bayside Tire & Exhaust, LLC v. State, W. 98-272, 10/13/1998. However, the Taxpayer feels that the Bayside Tire & Exhaust, LLC holding was incorrect and asks the Administrative Law Judge to reconsider his position on this issue. In Bayside Tire & Exhaust, LLC, the Administrative Law Judge held:

Bayside Tire is an LLC, and thus is treated as a partnership for tax purposes. Code of Ala. 1975, §10-12-8. Partners are jointly and severally liable for the debts of the partnership. Code of Ala. 1975, §10-8A-306. Consequently, the Taxpayer, as a member of Bayside Tire when the penalties accrued, is individually liable for those penalties.

Id. Section 10-12-8 does provide that a limited liability company is treated as a “partnership” for tax purposes. However, there is more than one form of partnership under Alabama law. Although partners in a general partnership are jointly and severally liable for the debts of the partnership, partners in a registered limited liability partnership are “not personally accountable, directly or indirectly . . . for debts, obligations and liabilities of . . . the registered limited liability partnership.” Code of Alabama, 1975 section 10-8A-306(c). Similarly, limited partners in a limited partnership are not generally liable for the obligations of the limited partnership. Code of Alabama, 1975 section 10-9B-303(a). The Bayside Tire & Exhaust, LLC holding unduly restricts the meaning of “partnership” to include only general partnerships. A limited liability company is more analogous to a registered limited liability partnership than a general partnership. Limited liability companies and registered limited liability partnerships are similar in that, for example, they both provide limited liability to their owners, their existences both become effective when required filings are made in probate court, and they are both required to maintain a registered office and registered agent. General partnerships have none of the foregoing characteristics. Thus, under section 10-12-8, a limited liability company should be treated for sales tax purposes as a registered limited liability partnership, rather than a general partnership.

It is important to note the distinction between taxes which are a

liability of a limited liability company and taxes which are a liability of its members. Under federal and state income tax laws, income of a limited liability company flows through the company to its members and the members are thus liable for tax on such income. Tax on the income of a limited liability company is never imposed on the company itself and the company itself is never liable for tax on its income. In other words, the members of a limited liability company are primarily liable for its income taxes. Alabama sales tax, however, is levied on the "person, firm, or corporation" engaged in the business of selling at retail. See Code of Alabama, 1975 section 40-23-2(1). Since Capitol Machine & Equipment Company, LLC, and not its members, are conducting the business of selling the Equipment, sales taxes are a liability of Capitol Machine & Equipment Company, LLC. The same applies in the case of a general partnership: a partnership that conducts a business activity which gives rise to a sales tax liability is primarily liable for such sales tax. However, the sales tax liability of a general partnership and a limited liability entity are different in that partners of a general partnership are secondarily liable for sales taxes of the general partnership because they are jointly and severally liable for the debts of the partnership. Conversely, the Taxpayer's members are not secondarily liable for the Taxpayer's sales tax liabilities, which are an obligation of the Taxpayer, because debts and obligations of limited liability companies, registered limited liability partnerships, and limited partnerships are not chargeable against the members, partners, or limited partners of such respective entities.

In Revenue Ruling 2004-41, the Internal Revenue Service clarified a similar issue, whether members of a limited liability company are liable for the company's employment tax liability. The Service held:

If under state law the members of the 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 from the members, including by levy on the property and rights to property of the members.

Rev. Rul. 2004-41, 04/30/2004. Like federal employment

taxes, Alabama sales taxes are a liability of the business entity conducting the business activity that brings about the tax liability. Since members and partners of Alabama limited liability companies and registered limited liability partnerships are not liable for the debts and obligations of their respective entities, the Department may not collect sales taxes from the Taxpayer's members.

If the holding in Bayside Tire & Exhaust, LLC is correct, members of limited liability companies would be personally liable for non-income taxes of the company, but partners in registered limited liability partnerships and limited partners in limited partnerships would not be liable for non-income taxes of such partnerships. We do not think the legislature intended such a result when it enacted section 10-12-8. We think that, in enacting section 10-12-20(a), the legislature clearly intended for members of limited liability companies to have the same limited liability protection as shareholders in a corporation and partners in a registered limited liability partnership.

Taxpayer's Brief at 8 – 11.

I now agree that *Bayside Tire* was incorrectly decided, and that members of an LLC are not personally liable for the non-income taxes owed by the LLC.

Code of Ala. 1975, §10-12-8(b) provides that an LLC shall be treated as a partnership, unless the LLC elects to be treated as a corporation. The Taxpayer in this case did not elect to be treated as a corporation. Code of Ala. 1975, §10-8A-306(a) provides generally that partners in a partnership are liable for the debts and obligations of the partnership. That statute also provides, however, that the partners are liable “. . . unless otherwise . . . provided by law.” Code of Ala. 1975, §10-12-20(a) specifies that members of an LLC are not liable for any debts or obligations of the LLC. Consequently, although an LLC may be taxed as a partnership, Alabama law otherwise provides that the members of an LLC are not liable for the debts of the LLC. The “unless otherwise . . . provided by law” caveat in §10-8A-306(a) thus applies, in which case LLC members cannot be held personally liable for the taxes owed by the LLC, other than their direct liability for income tax on their distributive share of the income of the LLC.¹

The above conclusion is supported by how the IRS assesses and collects

¹ Dept. Reg. 810-3-24.01(1)(a) specifies that for income tax purposes “[a] partnership is considered to be a ‘conduit’ of income to each partner and not a taxable entity under Alabama income tax law.”

taxes other than income tax from individual members of a multi-member LLC that has not elected to be taxed as a corporation. The IRS's position on the issue is set out in Revenue Ruling 2004-41, which is discussed in the above quote from the Taxpayer's brief, and also in Chief Counsel Advice 2002-350-023. The Chief Counsel Advice addresses the collection of tax, but applies equally to the assessment of tax. It provides in pertinent part as follows:

In analyzing an LLC's federal tax liability, the first consideration is whether an LLC is a single member LLC or a multi-member LLC. If it is determined that the LLC is a multi-member LLC, the next consideration is whether the LLC is taxed as a corporation or a partnership.

* * *

Most multi-member LLCs are taxed as partnerships, because association (taxed as a corporation) status is not elected. Thus, an income tax liability arising from an LLC's activities flows through to its members. If the Service filed a NFTL (notice of federal tax lien) to collect the income tax liability, a partner's name as the taxpayer is listed on the NFTL.

In regard to employment taxes, an LLC, like a partnership, could incur an employment tax liability as the employer. In that case, if the Service filed a NFTL, the partnership would be listed on the NFTL as the taxpayer.

A major difference, however, exists between a general partner's liability for the partnership's employment taxes and a member's liability when an LLC is treated as a partnership and incurs an employment tax liability: while each general partner is derivatively liable for the full amount of the employment tax liability under state law, no member of the LLC has any liability for the employment tax liability under state law. It must be emphasized that state law creates the difference in treatment between general partners and LLC members, not federal law.

When a partnership incurs an employment tax liability, under state law the general partners are liable for the tax, just as they are liable under state law for other debts of the partnership. See *Ballard v. United States*, 17 F.3d 116 (5th Cir. 1994); *United States v. Hays*, 877 F.2d 843, 844 n. 3 (10th Cir. 1989). When the Service files a NFTL in this situation, the Service lists the name of the partnership and the names of the known general partners, so that notice is provided of the federal tax lien

encumbering not only the partnership assets but also the general partners assets. I.R.M. 5.19.4.6.3(6).

In contrast, where an LLC has incurred an employment tax liability as a partnership, there is no state law imposing a derivative liability on the LLC's members. Indeed, quite the opposite occurs: state law explicitly provides that a member is not liable for an LLC's debts. See, e.g., Del. Code Ann. Tit. 6, § 18-303(a). Consequently, the Service cannot collect an employment tax liability from an LLC's member, even though the LLC is treated as a partnership for federal tax purposes, since the members have no derivative state-law employment tax liability. A NFTL for that liability should not be filed against the members, but solely in the name of the partnership as the taxpayer.

Since the members are not liable for the employment tax liability of the LLC taxed as a partnership, the Service may consider asserting the trust fund recovery penalty against members, depending on the facts and circumstances of the case.

The above is consistent with Alabama law in that while an LLC may be taxed as a partnership, Alabama law at §10-12-20(a) explicitly provides that an LLC member is not liable for the LLC's debts, including the taxes owed by the LLC.

The above applies to federal trust fund withholding and other employment taxes. The rationale should likewise apply to Alabama's withholding tax, sales and use tax, and other non-income taxes. For purposes of taxation, Alabama classifies an LLC the same as it is classified for federal tax purposes. See, Code of Ala. 1975, §10-12-8(b); Rev. Proc. 98-001. It follows that the members of an LLC should also be taxed (or not taxed) pursuant to federal guidelines. Consequently, consistent with the IRS's position on the issue, LLC members cannot be held personally liable for any taxes owed by the LLC.² But as under federal law, the members may, under the appropriate circumstances, be held personally liable for any trust fund taxes under Alabama's 100 percent penalty statutes, Code of Ala. 1975, §§40-29-72 and 40-29-73.³

² As discussed, income tax on the income of an LLC is a direct liability of the LLC members, and thus is not a tax owed by the LLC.

³ Code of Ala. 1975, §40-29-72(b) defines "person" for purposes of the 100 percent penalty to include "a member of a partnership." Consequently, because members of an LLC that has not elected to be taxed as a corporation are treated as (limited) partners in a
(continued)

In summary, reading §§10-12-8(b) and 10-12-20(a) together, members of LLCs that are taxed as partnerships are still LLC members, and thus, pursuant to §10-12-20(a), are not personally liable for the tax obligations and other debts of the LLC. That holding is consistent with how the IRS taxes such members for federal withholding and other employment taxes. Alabama law provides that where Alabama has adopted a federal provision relating to the determination of income for federal tax purposes, as in this case relating to the classification and treatment of LLCs, the use of federal judicial and administrative determinations as a guideline is appropriate. See, Code of Ala. 1975, §40-18-1.1; *Ex parte Jones Mfg. Co., Inc.*, 589 So.2d 208 (Ala. 1991). Consequently, the IRS's guidelines on the issue, which are consistent with Alabama law, should also be followed.

Capitol Machine at 8 – 13.

The above rationale is correct, and is adopted in this case.⁴ An LLC member may be personally liable for the trust fund taxes of the LLC, but only if the member is a responsible person under Alabama's 100 percent penalty statutes, Code of Ala. 1975, §40-29-72 and 40-29-73. For the reasons explained in *Capitol Machine*, the Taxpayer is not personally liable for the LLC's withholding tax liability, and is thus removed from the final assessment.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of

partnership, they are subject to the 100 percent penalty if they are responsible for paying the trust fund taxes of the LLC and willfully fail to do so.

⁴ The Administrative Law Division voided the final assessment in issue in *Capitol Machine* on other grounds. The Department did not dispute the rationale for voiding the assessment, but nonetheless applied for a rehearing because it disputed the Division's holding that an individual LLC member was not personally liable for the non-income taxes owed by the LLC. To avoid unnecessary legal expenses, the taxpayer agreed for the Administrative Law Division to issue a Final Order on Rehearing removing the above quoted language holding that LLC members are not personally liable for the LLC's non-income taxes. See, *Capitol Machine, supra*, (Admin. Law Div. Final Order on Department's Application for Rehearing 6/9/2009).

(continued)

Ala. 1975, §40-2A-9(g).

Entered April 15, 2010.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Mark Griffin, Esq.
David B. Anderson, Esq.
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