

Limits of Corporate Liability

Accountability for Taxes and Conduct is Still Personal

BY KEVEN DANOW

Almost everyone knows that business is done through corporations and limited liability companies (“LLC”) in order to avoid personal liability. While these business entities do provide a great deal of protection, there are areas of law in which these shields are quite porous.

New York’s business corporation law provides that, in most cases, the ten largest shareholders of a corporation are jointly and severally personally liable for all debts, wages, or salaries due and owing to any of its employees. The purpose of the statute is to make certain employees are not left without recourse if a corporation becomes insolvent. The ten largest shareholders are determined by valuing all of the shareholder’s beneficial interests in the corporation. This means that if the shares are held in a trust, it is not the trustee, but the beneficiaries, as equitable owners, who may be called upon to pay the debt.

All employers are required to report and pay certain payroll taxes. These taxes are broken down into two components. A portion of the tax is imposed upon the employer and is called the employer’s portion. The law requires the employer to withhold additional taxes from the employee’s pay and remit it to the taxing authority; the portion of the tax that is withheld and remitted by the employer is called the “employee portion” of payroll taxes. In essence, the employer pays the employee a full salary and then “takes back” the employee’s portion of the payroll tax and sends it to the State and Federal government. From the government’s point of view, the employer does not own the employee’s portion of the tax. It is holding it as an agent of the government. Consequently if the money is not

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remitted, it has been stolen from the employee and the government. Anyone who has signatory authority over a bank account or control over the funds of the employer can be held personally liable if this money is not remitted.

Like the employee portion of payroll taxes, sales taxes are a trust fund. When a restaurant or package store sells beverage alcohol, it does not “charge” sales tax. Rather it collects the tax as an agent of the state and local government. Once again, anyone who has signatory authority over a bank account or the power to direct where funds are paid may be held liable for any unremitted sales tax.

The shield offered by a corporation or LLC will not protect a person from his or her own wrongful conduct. Consequently, if a shareholder of a corporation tends bar and serves a consumer to the point of intoxication and the intoxicated patron causes an accident, the bartender will be personally liable under the dram shop act. Similarly, if a restaurant owner entertains at the restaurant and after drinking attempts to drive the guests home, the corporate structure will not protect against the consequences of drunk driving.

Similarly, individuals who engage in unlawful discrimination based on

race, creed, religion, place of national origin, disability or sexual preference will be liable for their wrongful conduct. Moreover, there is a legal theory in employment discrimination cases called the “cat’s paw.” It is based upon an old fable about a monkey that lusted for chestnuts which were roasting on an open fire. Rather than reach into the fire itself, the monkey convinced a cat to do its dirty work. The monkey was rewarded with chestnuts; the cat with severe burns. Under the “cat’s paw” theory, a person who convinces another to retaliate or otherwise take action against an employee based in whole or in part on wrongful discrimination is personally liable for those wrongful acts.

Because the protection is so powerful, attorneys universally urge their clients to take advantage of the limited liability protection of corporations, LLCs and similar entities. They also advise their clients to maintain the corporate proprieties to lessen attacks by claimants based upon claims that the entity is merely the alter ego of its owner. While this is good advice, it is important to remember that the shield provided by such entities is not an absolute protection. Make certain you remit the employee’s portion of payroll taxes, properly collect and remit sales tax and have sufficient funds set aside to pay your employees. In addition, obtain adequate liability insurance, including coverage related to the service of alcoholic beverages. Finally, remember you may always be held liable for your own conduct. Act reasonably! ■

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