



Business Brief

Business and Client Advisory

BEWARE – LIMITED LIABILITY COMPANIES DO NOT PROVIDE AN ABSOLUTE SHIELD TO INDIVIDUAL LIABILITY

The last ten years have seen an explosion in the organization of limited liability companies ("LLCs") in California. An LLC is a hybrid business entity, consisting of one or more individual or entity members who hold units in the company. An LLC has a legal existence separate from its members, but one or more of its members may actively participate in the management and control of the LLC. An LLC may be managed by all of its members or its members may appoint one or more individual or corporate managers from among its members or from an outside source to conduct the affairs of the LLC on their behalf.

One of the reasons LLCs are so popular is because LLC members receive the tax benefits of a general partnership without the same degree of individual liability exposure. However, contrary to a widely held belief, LLCs do not provide an absolute shield from individual liability. The applicable statutes have always provided that LLC members can be held individually liable for their conduct to the same extent as that of a corporate shareholder. So, while the exposure to individual liability within an LLC is significantly less than that of a general partnership, it still exists.

As for the liability exposure of LLC managers, the statutes are silent. However, managers must be careful not to conduct themselves under the false premise that they cannot be held individually liable as a result of performing their managerial duties. In the matter of *People v Pacific Landmark (2005) 129 Cal.App. 4th 1003*, the court held that while the manager of an LLC may not be held individually liable for the wrongful conduct of the LLC merely because of its managerial status, the manager may be held liable for its individual participation in tortious or criminal conduct, while in the course of performing managerial duties on behalf of the company. Thus, managers of an LLC can be held individually liable to the same extent as its members, even if they are not members and hold no ownership interest in the company. LLC managers must be aware of this exposure, especially in situations where LLC members are compelling them to conduct the affairs of the company in a manner which may run afoul of the law.

Vogt & Resnick has extensive experience in the formation of domestic and foreign limited liability companies and providing assistance to such entities in all aspects of business and legal affairs, including tax matters. Please contact us if you have any questions or want further information regarding limited liability companies.

PROTECTIVE CLAIMS AVAILABLE FOR FOREIGN LLCs IN CALIFORNIA

A Washington limited liability corporation recently prevailed in a lawsuit against the California Franchise Tax Board for the unconstitutionality of limited liability company fees (*Northwest Energetic Services, LLC, a Washington limited liability company vs. California Franchise Tax Board, an agency of the et. al., Case No. CGC-05-437721*). The Franchise Tax Board's appeal to that decision was filed on March 22, 2006 and is still pending.

If you own a foreign limited liability company (i.e. organized in a state other than California), the majority of gross revenue of which is generated outside the state of California, the California Franchise Tax Board ("FTB") has published the following instructions for those who wish to file a protective claim based on recent court cases like the one above:

The representative or limited liability company ("LLC") should fax a letter to the FTB with the following information:

- 1) LLC name and File Number issued by the California Secretary of State. Unregistered LLCs should reference the Identification Number issued by the FTB;
- 2) A statement indicating that it is a "Protective Claim;"
- 3) The effected tax years (Note: a separate Protective Claim must be filed for each year in which the fees are being challenged);
- 4) The amount of the Claim, which should match the amount of the annual fee that the LLC paid;
- 5) A description of the issue (stating that "the LLC fee is unconstitutional" is adequate);
- 6) Name of the person to contact on behalf of the LLC with phone and fax number;

The letter must be signed by the LLC's representative with power of attorney or signed by the LLC's managing member.

Although fax is preferred at (946) 845-9796, taxpayers may also mail their protective claims to Franchise Tax Board, P.O. Box 942867, Sacramento, California 94267-8888. The Franchise Tax Board will send an immediate fax confirmation of receipt, but it cannot e-mail confirmations due to confidentiality.

Please note the following:

- The fees for this year and any other years in which fees are delinquent must be paid or collections will continue on the liabilities.
- The statute of limitations for filing a protective claim is four years from the original file date of the income tax return or one year from the date of payment for the return.
- A space is not currently provided on the California Franchise Tax Return for LLCs for apportionment of income between that which was generated within California and that which was generated outside of California (i.e., in another state or country), so the fees are based upon gross receipts.

INTER-OFFICE DATING – WHAT DOES THE LAW SAY?

With people spending more and more time at work, it is not surprising to see that inter-office dating is on the rise. California employers have good reason to be concerned about sexual harassment in these situations, especially when the dating relationship is between a supervisor and a subordinate.

California law provides ample protection for employees in this area. For example, employers are prohibited from discharging or discriminating against employees for any lawful conduct which takes place outside the course of business and further, the California Supreme Court recently held that employees have a constitutionally protected right to engage in sexual activity as a matter of privacy and that this right to privacy may not be violated by employers.

An employee bringing a claim against an employer for violating his or her right to privacy, must prove there is: 1) a legally protected privacy interest; 2) a reasonable expectation of privacy under the circumstances; and 3) conduct on behalf of the employer which constitutes a “serious” invasion of privacy.

The courts have already determined that an employee’s sexual activity is a legally protected privacy interest. Therefore, the actual or threatened termination of an employee, or any disciplinary action taken against an employee, by an employer, based solely on that employee’s alleged romantic involvement with a co-worker, likely would be regarded as a serious invasion of privacy by the court.

By contrast, if an employer requires its employees to notify management of the existence of an office romance, this is likely to be considered a “minimal,” rather than a “serious,” invasion of the employees’ privacy because it does not prohibit the activity altogether, but provides the employer with the opportunity to effectively monitor the situation, take appropriate measures to reduce exposure to sexual harassment claims, and minimize any interpersonal conflict which may result in the workplace as a result. An employer is also well within its rights to regulate the outward demonstration, by employees, of this type of relationship in the workplace.

In simple terms, an employer may regulate inter-office dating, but may not prohibit it. Likewise, an employee engaging in this activity may reasonably expect not to be prohibited from it, but may expect it to be monitored in some manner by the employer.

Given the risks of exposure to sexual harassment law suits and inter-office conflict, it goes without saying, that any employer who becomes aware of such a situation should deal with it effectively and appropriately. Because this area of law is changing so rapidly, we recommend that business owners and supervisors review their inter-office dating and sexual harassment policies and procedures with an attorney. We frequently provide legal counsel to our clients in this and other employer-related matters. Please contact this office if you would like assistance with your review of your office policies and procedures.

THE IMPORTANCE OF PRE-EMPLOYMENT BACKGROUND CHECKS

California employers be warned: if you do not regularly conduct thorough pre-employment background checks of prospective employees, the details of the following story, taken from a recent California court case, may cause you to change your practices.

A law firm hired a paralegal without conducting a pre-employment background check or checking references. During the course of his employment, the law firm discovered that the paralegal previously was convicted of felonies that included theft and burglary, among other offenses. The employer-law firm confronted the paralegal with this information and asked the paralegal to resign from the firm, which he did.

The former employee-paralegal sued the firm for wrongful termination. Through further research, the defendant-law firm discovered that the plaintiff had a history of filing unmeritorious lawsuits. The defendant requested that the court dismiss the case on the basis that the plaintiff was a "vexatious litigant." After the defendant-law firm incurred significant time and expenses in its defense, the court ruled for dismissal.

The message of this story is simple: "check, check, check." Do not expose your business to frivolous lawsuits or other unnecessary losses. Make pre-employment background checking standard protocol for your business. Please contact this office if you would like our assistance with conducting pre-employment background checks.

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