Buyer Beware

Successor Tax Liability in an Asset Purchase

By Michael M. Antovski

fast facts

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One of the reasons for structuring an acquisition as an asset purchase is to limit the purchaser's responsibility for the liabilities and obligations of the seller.[1] In many instances, the asset purchase agreement will provide that the purchaser will assume only those liabilities identified and expressly assumed.[2] There is a common misconception, however, that the purchaser will avoid *all* liabilities and obligations of the seller except for those contractually assumed by the purchaser.[3] Michigan law is clear that a purchaser is liable for the tax liability of a seller if the purchaser fails to comply with the requirements of MCL 205.27a. Part 1 of this article will set forth the requirements of MCL 205.27a(1), Part 2 summarizes two cases that apply the strict requirements of MCL 205.27a(1), and Part 3 provides the practical application of MCL 205.27a(1) when entering into an asset purchase agreement.

Part 1: Requirements of MCL 205.27a(1)

The Michigan Department of Treasury has the authority to assess liability to a purchaser of assets for the unpaid taxes of a seller under the theory of "successor liability."[4] The assessment can occur despite the representations and warranties, and the obligations of the seller under the asset purchase agreement. To avoid successor tax liability, a purchaser must comply with the escrow requirement of MCLA 205.27a(1), which provides, in part, that:

> The purchaser or succeeding purchasers, if any, who purchase a going or closed business or its stock of goods shall escrow sufficient money to cover the amount of taxes, interest, and penalties as may be due and unpaid until the former owner produces a receipt from the state treasurer or the state treasurer's designated representative showing that the taxes due are paid, or a certificate stating that the taxes are not due. Upon the owner's written waiver of confidentiality, the department may release to a purchaser a business's known tax liability for the purposes of establishing an escrow account for the payment of taxes. If the purchaser or succeeding purchasers of a business or its stock of goods fails to comply with the escrow requirements of this subsection, the purchaser is personally liable for the payment of the taxes, interest, and penalties accrued and unpaid by the business of the former owner.

Accordingly, to escape successor tax liability in an asset sale, a purchaser must escrow sufficient funds to cover the taxes, interest, and penalties of the seller that may become due and unpaid. The funds must remain in escrow until the seller produces either a receipt from the Michigan Department of Treasury showing that the taxes due are paid, or a certificate stating that taxes are not due (tax clearance). Upon receipt of tax clearance, the funds can be released from escrow and the purchaser will be protected from successor liability.

Part 2: Caselaw

Many practitioners believe that a representation or warranty by the seller in the asset purchase agreement that states that the seller has paid all taxes due as of the closing would shield a purchaser from successor tax liability. The first case summarized, *STC, Inc v Dep't of Treasury,*[5] holds to the contrary. The second case, *Greenfield Plaza Assoc, Inc v Michigan Dep't of Treasury,*[6] demonstrates the broad application of successor tax liability and the interpretation of "purchase" for purposes of MCL 205.27a(1).

The Successor Tax Liability is Not Limited to Tax Liability as of the Date of Purchase

In *STC, Inc v Dep't of Treasury,* the Court of Appeals held that MCL 205.27a(1) does not place limitations on the liability of the purchaser based on the timing of the purchase. The purchaser was in the due diligence phase of purchasing the assets related to a McDonald's restaurant. In reviewing the company books of the seller, the purchaser concluded that the seller was "current" in its payment of estimated taxes as of the date of purchase. On the basis of this conclusion, the purchaser did not find it necessary to escrow funds for any future taxes owed by the seller. Two years following the asset purchase, the seller filed its tax returns but failed to submit payment. The Michigan Department of Treasury could not track down the seller and notified the purchaser of its responsibility for the tax deficiency as a successor business. The purchaser asserted that reasonable investigation led to the conclusion that the seller had no outstanding tax liabilities at the *time of the purchase.* The Court of Appeals concluded that "the plain language of the statute does not limit or prorate the tax liability of the purchaser to the date of purchase."[7] Rather, the purchaser must establish an escrow account to cover taxes, interest, and penalties until the seller produces payment or obtains a tax clearance from the Michigan Department of Treasury.

MCL 205.27a(1) Does Not Require a Purchaser to Acquire All the Assets of a Business for Successor Tax Liability to Arise

In *Greenfield Plaza Assoc,* a tenant rented retail facilities from its landlord and owed back rent. The landlord agreed to waive the back rent if the tenant agreed to vacate the leased premises and convey to the landlord all the furniture, fixtures, leasehold improvements, and rights to the lease interest. The Michigan Tax Tribunal held that a landlord was liable as a "successor" for the unpaid taxes of its defaulting tenant despite the fact that the landlord did not acquire the trade name, inventory, customer lists, or employees of goodwill of the tenant, nor did the landlord conduct any retail operations. The landlord contended that it did not

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purchase a "going business" or "closed business" or its "stock of goods" within the meaning of MCL 205.27a(1), but instead merely acquired certain non-inventory assets from the tenant in satisfaction of past due rental obligations of the tenant. The Tribunal concluded that the statute does not require a purchaser to acquire all the assets of a business for liability to arise in the purchaser, nor is successor tax liability avoided if the "seller of all or part of a business restarts the same or similar business at a new location."[8] Given this broad interpretation, the Tribunal concluded that the tenant transferred substantial business assets to the landlord and, therefore, "sold its business" within the meaning of the statute.

The Direct Payment of Purchase Money from the Purchaser to the Seller is Not Necessary for the Purchaser to be Liable for any Delinquent Sales Tax Owed by the Seller

In *Greenfield Plaza Assoc,* the landlord also argued that, to the extent that money did not actually change hands, because such funds represented the satisfaction of the tenant's delinquent rental obligations to the landlord, it could not have withheld funds from the sale. The Tribunal concluded that "it is no defense that some of the consideration took the form of a discharge of debt. It has been held that the direct payment of purchase money from the purchaser to the seller is not necessary for the successor to be liable for any delinquent sales tax owed by its predecessor."[9]

Part 3: Practice Tips When Dealing with MCL 205.27a(1)

During the due diligence phase, the buyer should require the seller[10] to request that the Michigan Department of Treasury conduct a review of the business tax account of the seller for tax clearance purposes and provide information regarding any outstanding tax liabilities.[11] If there are no outstanding tax liabilities, the Michigan Department of Treasury will issue a tax clearance certificate stating that no taxes are due. The issuance of the tax letter confirms whether the seller is current with its tax obligations to the State of Michigan. The tax letter is typically used to determine how much of the purchase price to place in escrow. In making this determination, the parties should consult with their respective accountants and add an additional amount to the escrow for estimated additional tax liabilities of the seller due or owing. Once the escrow amount has been established, the seller will need to request tax clearance from the Michigan Department of Treasury. Depending on whether the seller will continue in existence following the sale, there are two forms to choose from with regard to obtaining a tax clearance certificate from the Michigan Department of Treasury. If the seller will continue to be in existence following the sale, the seller should request "conditional tax clearance" by completing Michigan Department of Treasury Form 514, "Conditional Tax Clearance Request."[12] If the seller will dissolve following the sale, the seller should request tax clearance by completing Michigan Department of Treasury Form 501, "Tax Clearance Request for Corporation Dissolution or Withdrawal."[13]

Conclusion

Practitioners should be aware that a purchaser is liable for the tax liability of a seller if the purchaser fails to comply with the requirements of MCL 205.27a(1). Accordingly, the asset purchase agreement should set forth as a pre-closing condition that the seller and buyer comply with MCL 205.27a(1) and establish an escrow account to cover taxes, interest, and penalties until the seller produces payment or obtains a tax clearance. ■

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FOOTNOTES

1. See *Model Asset Purchase Agreement: With Commentary* (ABA, 2001), p xvi.
2. *Id.*
3. *Id.*
4. The purchaser's personal liability is typically limited to the fair market value of the business less the amount of any proceeds that are applied balances on secured interests that are superior to the lien provided for in Section 29(1) as referenced in MCLA 205.27a(1).
5. *STC, Inc v Dep't of Treasury,* 257 Mich App 528; 669 NW2d 594 (2003).
6. *Greenfield Plaza Assoc, Inc v Michigan Dep't of Treasury,* 2005 Mich Tax LEXIS 9 (Docket No. 278490, January 19, 2005).
7. *Id.* at 536 (citing to *In re MCI Telecom Complaint,* 460 Mich 396, 411; 596 NW2d 164 (1999)).
8. *Greenfield, supra.*
9. *Id.* (citing to *Bank of Commerce v Woods,* 585 SW2d 577; *A. Copeland Enterprises v Commissioner of Revenue,* 703 SW2d 624 [interpreting the Alabama sales tax statute for successor liability (Code of Ala. 1975 § 40-23-25)]).
10. Upon the seller's written waiver of confidentiality, the Michigan Department of Treasury may release to a purchaser a seller's tax liability for the purposes of establishing an escrow account for the payment of taxes. This can be accomplished by having the parties complete Michigan Department of Treasury and Unemployment Insurance Agency (UIA) Form 151, which can be obtained at: <http://www.michigan.gov/documents/151f_2765_7.pdf>. All websites cited in this article were accessed February 12, 2009.
11. Michigan Department of Treasury, *Tax Clearance* <http://www.michigan.gov/taxes/0,1607,7-238-43519_43526---,00.html>.
12. Michigan Department of Treasury, *Conditional Tax Clearance Request Form 514* <http://www.michigan.gov/documents/514f_3584_7.pdf>.
13. Michigan Department of Treasury, *Tax Clearance Request For Corporation Dissolution or Withdrawal Form 501* <http://www.michigan.gov/documents/501f_3581_7.pdf>.