Section 6901

Transferee Liability

2017 Managing Tax Audits and Appeals Seminar

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Section 6901

For tax liabilities within its scope, this Code section provides a procedure for the liability to be "assessed, paid, and collected in the same manner and subject to the same provisions and limitations" with respect to the transferee as with respect to the person who owes the underlying taxes.

The alternative would be for the IRS to sue in state court as a creditor, a less desirable forum and procedure from the Government's point of view.

In theory, section 6901 merely provides a federal forum and does not change the ambit of liability.

Section 6901

Applies to: income, gift, and estate tax liabilities, and some other tax liabilities in certain circumstances.

Applies to liabilities “at law or in equity.”

“At law” basically means contractual or statutory liability and “in equity” refers to court-based doctrines of liability.

Section 6901

Statute of limitations: original limitations period plus one year.

Transferee of transferee: first transferee's limitations period plus one year, but not to exceed three years after the original limitations period runs.

If a court proceeding has begun against the original taxpayer or the last preceding transferee, the Government has one year after the "return of execution" in that proceeding.

Liability is a Matter of State Law

"The Government's substantive rights in this case are precisely those which other creditors would have under [state] law." Commissioner v. Stern, 357 U.S. 39, 47 (1958).

Thus, the question of whether a person is a "transferee" is also a question of state law.

Of course, whether the underlying tax liability is owed is a matter of federal law.

Liability at Law

There is liability at law if the purchase agreement expressly provides that buyer assumes the tax liability.

Lest assumption be read into the contract, it is best to expressly disclaim assumption.

Another example of assumption by operation of law is a statutory merger.

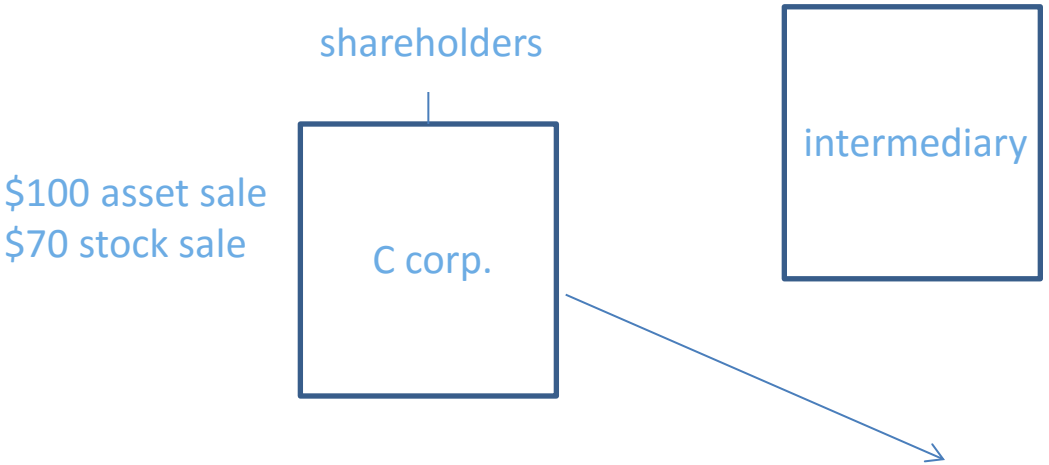
To the extent that fraudulent conveyance law is embodied in a statute, such as the UFCA, liability for fraudulent conveyance is a liability at law.

Liability in Equity

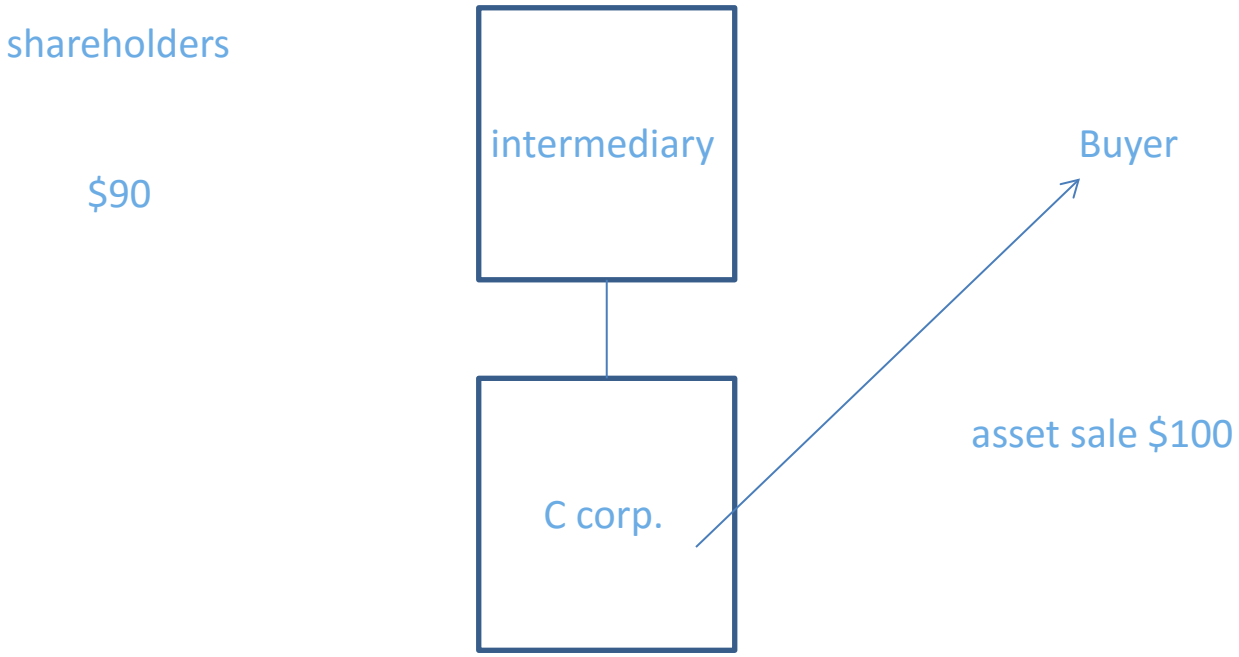
Successor liability

- Need to identify a transferor and a transferee
- State law is amorphous – there are situations where a good faith purchaser for value gets stuck with some or all of the transferor's liabilities.

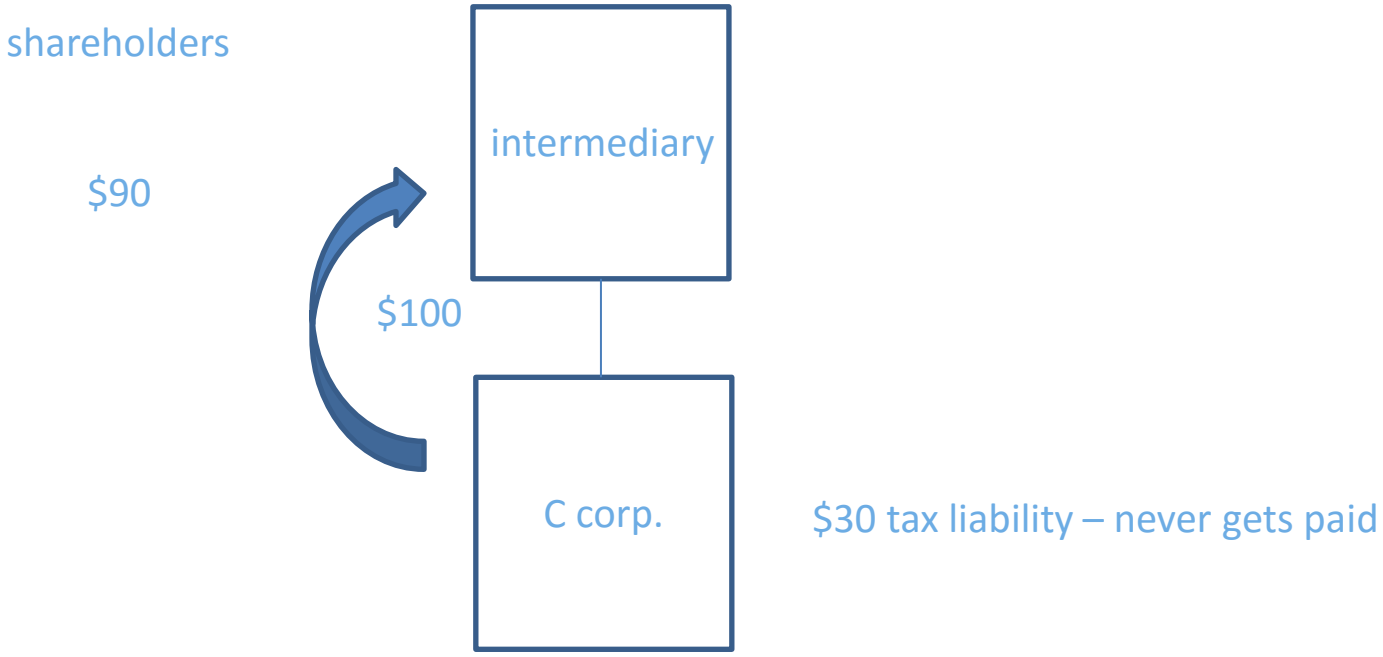
Midco Cases


shareholders
intermediary
$100 asset sale
$70 stock sale
C corp.

Midco Cases



Midco Cases


shareholders
$90
intermediary
$100
C corp.
$30 tax liability – never gets paid

Midco Transactions Are Listed Transactions

IRS Notice 2001-16

The following theories are suggested:

Midco is seller's agent

Midco is buyer's agent

The transaction is otherwise characterized to treat the shareholders as selling assets, or the target as selling assets while owned by s/hs

Midco Cases

In Diebold Foundation, 736 F.3d 172 (2013), the 2nd Circuit held that actual knowledge of a plan to defraud creditors or constructive knowledge of such a plan allowed the Midco transactions to be collapsed, so as to impose transferee liability on Sellers (despite the fact that Sellers sold the target company before the corporate tax liabilities arose).

This collapsing was not driven by a tax analysis but an application of NY fraudulent conveyance law.

The customary contractual allocation of tax liabilities in the purchase agreement did not relieve Sellers of a duty to inquire further into the circumstances of the transaction.

Midco Cases

In Starnes, 101 TCM 1283 (2011), the Tax Court, applying North Carolina law, held that the taxpayers had neither actual knowledge of a plan to defraud creditors nor constructive knowledge of such a plan, so that the collapsing of the Midco transactions was not allowed. The Tax Court apparently took into account the lack of sophistication of the taxpayers.

The taxpayers received representations from Buyer that it would pay the corporate level tax.

This case was affirmed by the 4th Circuit, 680 F.3d 417 (4th Cir. 2012).

Midco Cases

In Frank Sawyer Trust, 712 F.3d 597 (1st Cir. 2013), the 1st Circuit rejected a collapsing argument, but got to the same result by adopting a "transferee of a transferee" theory that was not even argued.

The basic point was that the Intermediary, which obtained cash from the C corporation target, had liability for the target's tax debts as a transferee. The Ist Circuit held that if the Intermediary overpaid for the target's stock, to the extent of the overpayment, the former shareholders of target owed the IRS.

This approach seems to ignore the **timing** of these transactions.

Caveat Vendor!

Lessons from the case law, which continues to develop:

Do the due diligence on who the buyer is and what the buyer's plans are for the business post-sale.

Where appropriate, get representations regarding those issues. (But representations cannot be counted on to override knowledge or constructive knowledge.)

If a deal is too good to be true absent tax fraud, you might be deemed to have constructive knowledge.

Caveat Emptor!

Even a good faith purchaser for value can be stuck with successor liability.

Each state has a different approach.

Questions?

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