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Buyers Beware (Of Transferee Tax Obligations)

Abstracted from: *Transferee Liability: What, Me Worry?*
By: Robert Wood
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Chasing taxes even after the taxpayer is gone. Tax obligations do not disappear just because the taxpayer/company does, warns Robert Wood. IRC Section 6901 allows the IRS to pursue corporate tax liabilities as long as the liquidated company has transferred its assets to another party. Using this procedural mechanism, the IRS can even chase indirect transfers. For example, paying dividends to a majority shareholder by canceling that shareholder's debt is an asset transfer within the scope of Section 6901. The IRS can seek remedies from the transferee/shareholder for the unpaid taxes.

Time is not of the essence. If a shareholder is not contractually liable for the liquidated corporation's overdue taxes, the IRS can go after the funds in equity. This avenue is open when an insolvent company has transferred assets for little or no consideration. In one of the cases cited by the author, the IRS sought back taxes from the shareholders after the reorganization of a trash-hauling company. Because the merger had occurred in 1990, the owners assumed they were free and clear of tax issues from their old company by 1999—until the IRS issued liability notices to each one and the Tax Court agreed. Both owners were held responsible for fraudulent transfers under applicable state law, so the usual three-year statute of limitations was not applicable, the Tax Court held.

Contractual liabilities may be worse. The general rule is that a transferee's liability cannot exceed the value of the transferred assets, but this protection applies only when the IRS is asserting equitable grounds for the liability. Transferee liability arising from contractual obligations can sometimes be worse. The author writes of an auto dealership that absorbed its finance affiliate in a statutory merger. The finance company owed taxes from 1990, seven years before the merger took place, and the IRS assessed the back taxes against the new combined entity. The dealership's argument that the transfer liability requirements had not been met (because the merger was for adequate consideration) failed. The merger agreement showed that the dealership had agreed to pay all liabilities for both companies, even though the transferred assets were worth less than the back taxes the IRS was seeking: not a great deal for the dealership, but a win for the IRS.

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