

Who's A Successor in Interest?

By Robert W. Wood • Wood LLP

When one company buys another, the acquirer usually wants all the good and as little of the bad as possible. For example, an acquirer wants to hire the employees it needs, but not everyone. And the acquirer hardly wants to take on payroll liabilities for independent contractors that might later be reclassified.

That is one reason successor employment liabilities can become relevant. In a recent Tax Court case, *TFT Galveston Portfolio, LTD* [144 TC No. 7, Dec. 60,238 (2015)], the court considered a Texas partnership owned by Mr. Teachworth and an LLC Teachworth controlled. TFT owned and managed four

apartment complexes that were transferred to it by several other partnerships in which Teachworth had large ownership stakes.

TFT did not expressly assume the liabilities of the other partnerships. None of the partnerships ever filed any federal payroll returns or paid any federal payroll taxes. Teachworth was the only owner actively involved.

The partnerships had: (1) apartment managers and leasing agents, (2) a maintenance supervisor, (3) security personnel, and (4) general maintenance workers. There were potential worker status problems with all of these “independent contractors,” some more obvious than others. For example, there were no written agreements, and Mr. Teachworth controlled them rather rigorously.

He established all of their duties, leaving them with little to no discretion in how services were to be performed. Since the employment liability was large, the IRS sought to collect all of the payroll taxes and penalties from TFT. The IRS claimed that TFT was a successor in interest and sought to have federal common law apply for purposes of determining whether TFT was a successor in interest.

But TFT relied on Texas law, under which there was no liability absent an express assumption of it. [See Tex. Bus. Orgs. Code Ann. Sec. 10.254(b).] The Tax Court held that state law, not federal common law, applies to determine if taxpayer was a successor in interest. The IRS argued that because the uniform imposition and collection of employment taxes is a significant federal interest, the court should apply federal common law in determining successor liability in employment tax cases.

But the court said there was no significant conflict between a federal policy or interest and the use of state law here. Besides, the court said the IRS could pursue transferee liability under Code Sec. 6901. Alternatively, the IRS could collect from Mr. Teachworth under the responsible person rules in Code Sec. 6672.

The court looked to Texas case law and concluded that in Texas, an acquiring entity is not a successor in interest unless it expressly agrees to assume the liabilities. As a result, TFT was liable for taxes and penalties with respect to all of its employees’ compensation and for none of the taxes and penalties with respect to the employees of the other partnerships.

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