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## **NEWLY FORMED CORPORATION WAS LIABLE FOR EMPLOYMENT TAX LIABILITY AS SUCCESSOR IN INTEREST**

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The IRS Chief Counsel concluded that a new corporation can be **liable for another corporation's liability as a successor in interest where the other corporation, after an IRS levy, discontinues operations and transfers its contracts to a new corporation that then operates the same business with the same employees, equipment and customers.** Further, as a successor in interest, IRS doesn't have to make additional assessment against the new corporation to file a lien or levy.

**Facts:** Company A, a Puerto Rico corporation that operated a business and had contracts with several corporate customers, owed employment tax liabilities for Years 1, 2, and 3. IRS filed federal tax liens and levied on its accounts receivable, collecting only a part of the amount owed. After the levy, Company A's president, Mr. Y, **discontinued operations. Mr. Y formed a new corporation, Company B.** Although Mr. Y wasn't listed as one of Company B's incorporators, his **wife Ms. Z, who was also Company A's vice president, was so listed.** Mr. Y claimed that he wasn't an officer of Company B. Company B's officers are unknown, and both Company A's and Company B's shareholders are unknown. Mr. Y admitted closing Company A because of the levy and opening Company B to keep Company A's employees working. Any assets Company A owned are now used by Company B. Company A's former customers now make payments to Company B.

**Background on successor liability:** Successor liability is generally determined under state law. **A corporation that acquires the assets of another corporation is not liable for the debts of the transferor corporation unless: (1) the successor expressly assumes the liabilities; (2) the transaction amounts to a de facto merger; (3) the successor is a mere continuation of the seller corporation; or (4) the transaction is entered into fraudulently to escape liability.**

**Background on alter ego doctrine:** State law also generally determines when a corporation is an alter ego. The alter ego doctrine generally involves **piercing the corporate veil** to hold a shareholder liable for a corporation's debt or **"reverse piercing" to hold the corporation liable for a shareholder's debt.** Some jurisdictions have imposed alter ego liability absent a formal stock ownership relationship. Courts consider the following factors: (a) the stockholder's **control** of corporate affairs; (b) the treatment of **corporate assets as personal assets**; (c) the unrestricted withdrawal of corporate capital; (d) the **commingling of corporate and personal assets**; (e) the **inadequate structure of corporate capital**; (f) the **lack of corporate records**; (g) the **non-observance of corporate formalities**; (h) inaction of the other officers and directors; (i) **failure to declare dividends**; (j) the stockholder's holding himself or herself out as being personally liable for the obligations of the corporation; and (k) **management** of the corporation without regard to its independent existence.

**Theory of liability:** The CCA concluded that successor liability applied in this case because the transaction was entered into for the **fraudulent purpose of escaping liability** (see (4), above). Under Puerto Rican law, a presumption of fraud on creditors arises when a **debtor transfers property for no consideration.** Company A transferred assets to Company B for no consideration after Company A owed a federal tax liability. Further, Company A's acts (via Mr. Y) showed an intention to avoid creditors. Mr. Y **admitted starting Company B because of the IRS levy.** The facts militate towards a finding that the transaction was nothing but an **attempt to escape liability.** The CCA reasoned that recognition of both Company A and Company B would sanction fraud. A corporation that goes through a **mere change in form without a significant change in substance shouldn't be allowed to escape liability.**

The CCA also concluded that a new assessment against Company B or a new collection due process (CDP) wasn't required. A **successor corporation steps into the transferor corporation's shoes.** As an assessment already existed for Company A, no **new assessment was needed.** If proper notices of lien filing and intent to levy were issued to Company A, successor Company B wasn't entitled to a CDP lien and levy notices and a second CDP hearing. Analysis of successor liability under the de facto merger and mere continuation exceptions ((2) and (3), above)—often used by courts interchangeably—generally look to whether the successor corporation shares common officers,

directors and shareholders with the transferor corporation. Other factors that may be considered are continuity of business operations, management, assets, personnel and physical location. However, the CCA noted, for a transaction to constitute a de facto merger, some courts require that the successor's stock be transferred to the original corporation's shareholders in exchange for the assets of the original corporation. As Company B didn't transfer stock in exchange for assets, the de facto merger theory wouldn't apply.

**Whether a corporation is a mere continuation depends on:** (1) a corporation **transferring its assets**; (2) the acquiring corporation paying **less than adequate consideration** for the assets; (3) the acquiring corporation **continuing the divesting corporation's business**; (4) both corporations **sharing at least one common officer** who was instrumental in the transfer; and (5) the divesting corporation being **left incapable of paying its creditors**. The CCA concluded that the mere continuation theory couldn't be relied on in this case because the identity of both corporations' stockholders and the Company B's officers are unknown. While the Puerto Rico Supreme Court refused to find a merger or identity between two corporations because there was no evidence of commonality of corporate ownership, directors, officers, stockholders, or operations, the CCA noted that an argument on this ground might still be made because in certain circumstances the Court has applied a more liberal test that didn't require a continuity of ownership and management.

**Alter ego analysis:** The CCA also notes that Puerto Rico law recognizes the alter ego doctrine and appeared to recognize its application to a corporate shareholder. However, a critical consideration in evaluating whether Company B is an alter ego of Company A is whether sufficient stock ownership or control exists to justify application of the alter ego doctrine. If neither corporation owns stock of the other or exercises control of the other, then an alter ego relationship between Company A and Company B doesn't exist and an alter ego lien wouldn't be appropriate. If, however, one corporation controls the other so that their separate status should be disregarded, an alter ego lien would be appropriate.