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DEPARTMENT OF TREASURY
LANSING

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SUCCESSOR LIABILITY

Pursuant to MCL 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006, and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

RAB 2018-19. This Revenue Administrative Bulletin (RAB) explains the law governing the potential tax liability of a purchaser or succeeding purchaser (“purchaser”) of a going or closed business or its stock of goods (commonly referred to as “successor liability”).

ISSUES

- I. What is “successor liability?”
 - A. In general.
 - B. What is a “purchase?”
 - C. What taxes are subject to successor liability?
- II. What must the purchaser of a going or closed business or its stock of goods do to prevent or mitigate successor liability?
 - A. How does a purchaser comply with the escrow requirement?
 - B. How does a purchaser request a “tax clearance certificate?”
 - C. What reduces successor liability if a purchaser fails to comply with the escrow requirement?

CONCLUSIONS

I. Elements of Successor Liability

- A. In general.** When a person or entity purchases a business or some or all of its stock of goods, it may be held liable for taxes owed by the business in certain circumstances.¹ This is commonly referred to as “successor liability.” Such purchasers are liable if they fail to meet certain escrow requirements when they purchase a business with a Michigan tax liability and that business fails to pay its liability. Specifically, the Revenue Act provides:

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 taxes are not due [i.e., a “tax clearance certificate”]... If the purchaser or succeeding purchasers of a business or its stock of goods fail 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.²

Successor liability is derivative liability. That is, the successor is held liable for the assessed taxes of another. This is to ensure that the State of Michigan is paid prior to the delinquent seller. A successor may not challenge the underlying assessment that was issued to the seller, due to its derivative nature.³

Example 1: ABC purchases XYZ without escrowing sufficient funds to cover the tax liability of XYZ and a tax clearance certificate is never issued. As a result, ABC is assessed for the tax liability as a successor. ABC believes that a final assessment issued to XYZ was improper because XYZ was not liable for the tax at issue. ABC may not challenge the assessment issued to XYZ. However, if timely appealed, XYZ may challenge the assessment in a separate proceeding.

The Department is statutorily required to assess successors prior to assessing any corporate officers as responsible persons if the Department has information that identifies the successor and determines that assessment of the successor would allow the Department to collect the entire assessment of the business.⁴

¹ MCL 205.27a(1).

² MCL 205.27a(1).

³ Cf. *Keith v Dep't of Treasury*, 165 Mich App 105 (1987) (holding that a person assessed as an officer under MCL 205.27a(5) is not permitted to challenge the underlying assessment). 2014 PA 3 amended MCL 205.27a(5) to expressly allow an officer to challenge the underlying assessment issued to the business; however, no such change was made to MCL 205.27a(1) regarding successor liability. Challenging a final assessment issued against the seller that was not timely appealed, or that has already been fully litigated by the seller, would also constitute an impermissible collateral attack on the assessment. MCL 205.22(4).

⁴ MCL 205.27a(5).

- B. “Purchase.”** A “purchase” of a going or closed business or its stock of goods is required for a purchaser to be liable as a successor. Any consideration, including cancellation of debt, that is exchanged for a going or closed business or its stock of goods is sufficient to constitute a “purchase.” The purchaser is not required to acquire *all* of the assets of a business in order to be liable as a successor; acquisition of some portion of them is sufficient.⁵ “Purchase” may include the transfer of title, possession, or both. However, mere foreclosure of a secured interest, without an actual purchase of the going or closed business or its stock of goods, does not create successor liability.

Likewise, if a lessor evicts a business tenant and re-leases the property to another party without either party purchasing the evicted business or its stock of goods, neither the lessor nor the new lessee is liable as a successor.

Example 2: ABC finances XYZ’s purchase of equipment for use in XYZ’s manufacturing business. XYZ goes out of business and fails to make required payments to ABC; ABC exercises its rights under the finance agreement and repossesses the property. This is not a purchase for purposes of successor liability.

Example 3: ABC finances XYZ’s purchase of equipment and supplies for XYZ’s party store. XYZ fails to make payments to ABC. ABC and XYZ reach an agreement whereby ABC will forgive the past due and remaining debt in exchange for XYZ’s business. This is a purchase; ABC may be liable as a successor.

Example 4: ABC leases real estate to XYZ to operate a party store. XYZ goes out of business with an outstanding tax liability and vacates the premises after defaulting on its lease. Subsequently, ABC leases the property to DEF. DEF opens a party store under its own name and had no transactions with XYZ. When DEF takes over the premises some of XYZ’s stock of goods are still located in the building. This is not a purchase for purposes of successor liability.

Example 5: ABC leases real estate to XYZ to operate a party store. XYZ is delinquent on its rent payments in the amount of \$50,000. ABC and XYZ execute a sale agreement whereby ABC will forgive XYZ’s debt in exchange for XYZ’s property and business. This is a purchase; ABC may be liable as a successor.

- C. Taxes subject to successor liability.** Successor liability may arise for unpaid tax liabilities for any tax that is administered under the Revenue Act (including Michigan Business Tax (MBT), Corporate Income Tax (CIT), and sales, use, and withholding taxes). The amount of money escrowed must be sufficient to cover the amount of “taxes, interest, and penalties as may be due and unpaid.” The phrase “as may be due and unpaid” relates to tax liabilities that are both known and unknown at the time of the purchase of the business.⁶ When a

⁵ To the extent that a person purchases less than an entire business, such as select assets, that person may only be liable up to the fair market value of the property purchased.

⁶ *STC, Inc. v Dep’t of Treasury*, 257 Mich App 528, 534-535 (2003).

business is required to make estimated payments, it may underpay its tax and not become aware of the underpayment until it files an annual return. Because the deficient estimated payment was a tax due at the time it was underpaid, it is a present obligation and is subject to successor liability even though it was unknown at the time the business was purchased by the successor.⁷

Example 6: ABC purchases XYZ without escrowing sufficient funds to cover the tax liability of XYZ and a tax clearance certificate is never issued. After the sale of XYZ to ABC is complete, XYZ files its annual CIT return reflecting a balance due because XYZ's estimated payments were not sufficient to cover its CIT liability. XYZ did not remit a payment with its return and is assessed. XYZ fails to pay the assessment. ABC is liable as a successor.

II. Escrow and Tax Clearance

In general, the purchaser of a going or closed business or its stock of goods is not liable as a successor if the purchaser escrows 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 taxes are not due (i.e., a tax clearance certificate).⁸

A. Escrow requirement. To constitute a valid escrow account for purposes of successor liability, the escrow account must be maintained for the purpose of covering the amount of taxes, interest, and penalties the selling business may owe to the state of Michigan, and not some other purpose. The escrow account may be maintained at a bank or other institution so long as there is a formal escrow agreement in place. The escrow must be maintained until the seller of the business or stock of goods produces a tax clearance certificate or a receipt issued by the Department indicating taxes due have been paid.⁹ The purchaser is not required to give notice to the Department that it is escrowing funds. However, if the Department asserts the purchaser is liable as a successor, the purchaser must produce evidence that it escrowed sufficient funds for the requisite time period (i.e., until issuance of a tax clearance certificate or a receipt showing taxes due are paid). If a tax clearance certificate is requested and the Department timely responds by indicating the seller has an outstanding known or estimated tax liability, the purchaser must continue to maintain its escrow account in that amount until the seller satisfies the tax liability and produces a tax clearance certificate. The Department may limit the amount of time that a purchaser may rely on the Department's determination of the required escrow amount. If the sale of the business or stock of goods has not concluded by the time period prescribed by the Department, a new statement of the seller's known or estimated tax liability must be requested, and the escrow amount adjusted accordingly to comply with the escrow requirement. If the purchaser complies with the escrow requirement, the purchaser is not liable for any amounts that exceed the known or estimated tax liability disclosed by the Department.

⁷ *Id.*

⁸ MCL 205.27a(1).

⁹ Since successor liability is derivative liability, assessment and collection from the seller can be made within the statute of limitations on collection of the seller under MCL 600.5813.

B. Tax clearance. Two requirements must be met to make a valid request for a tax clearance certificate:

1. there must be a written *request* for a tax clearance certificate, and
2. the seller must provide a written *waiver* of confidentiality in favor of the purchaser.

The Department's *Request for Tax Clearance Application* (Form 5156) meets both of these requirements if properly completed and is the only document that may be submitted to the Department to request a tax clearance certificate. The submission of a purchase agreement or any other documentation not on the Department's form will not be accepted.

Within 60 days of receipt of a completed *Request for Tax Clearance Application* (Form 5156) the Department will release to the purchaser the seller's known or estimated tax liability or a tax clearance certificate indicating the seller has no known or estimated tax liability. The Department may estimate the tax liability based on other available information if it believes that returns or payments made do not supply sufficient information for an accurate determination. If the Department fails to respond to a valid request within 60 days of receipt the purchaser cannot be held liable as a successor.

Only the seller may request the tax clearance certificate. If the Department determines that the seller is not eligible for a tax clearance certificate it will state the reasons why, and the known or estimated tax liability. After remedying the issues identified by the Department, the seller must submit a new request for a tax clearance certificate.

Example 7: ABC purchases XYZ and escrows sufficient money. XYZ submits the purchase agreement to the Department without specifying that it is requesting a tax clearance certificate. XYZ has not made a proper "request" for tax clearance.

Example 8: ABC purchases XYZ and escrows sufficient money. XYZ submits a completed *Request for Tax Clearance Application* (Form 5156). The Department responds more than 60 days after receipt of the request indicating XYZ has a tax liability of \$100,000. ABC closed its escrow account and withdrew the money 61 days after the Department received the request. ABC is not liable as a successor.

Example 9: ABC purchases XYZ and escrows \$100,000 to cover potential tax, penalty, and interest as may be due and unpaid. XYZ submits a completed *Request for Tax Clearance Application* (Form 5156). The Department responds timely and indicates that XYZ has a known or estimated tax liability of \$50,000. ABC may reduce its escrow to \$50,000; however, to avoid successor liability it must maintain the escrow until the Department issues a tax clearance certificate.

C. Fair market value of the business and secured interests. If a purchaser fails to comply with the escrow requirement, its successor liability is limited to the fair market value of the

business less the amount of any proceeds that are applied to balances due on secured interests that are superior to the State's lien(s) under MCL 205.29(1).

When a purchaser fails to comply with the escrow requirement and asserts that the tax liability exceeds the fair market value of the business, the purchaser must demonstrate the fair market value of the business with objective information, such as an appraisal. For purposes of successor liability, "fair market value" is the value of the business on the date of the sale, but may be different than the purchase price. The fair market value of the business includes, but is not limited to, tangible personal property, real property, intangible property (such as copyrights and trademarks), liquor licenses, goodwill, and any other property or item of value that is exchanged for consideration in the course of the sale of the business or its stock of goods. If the fair market value of the business exceeds the purchase price the purchaser may be liable for unpaid tax as a successor up to the fair market value of the business.

Example 10: ABC purchases XYZ and fails to comply with the escrow requirement. ABC is assessed \$100,000 as a successor. ABC provides an accurate and objective appraisal of XYZ's business determining that the fair market value of XYZ was \$60,000 as of the date of the sale of the business to ABC. ABC is only liable for \$60,000.

Example 11: ABC purchases XYZ for \$50,000 and fails to comply with the escrow requirement. XYZ had \$75,000 in tax liability when ABC purchased it. The fair market value of XYZ at the time of the purchase was \$100,000. ABC is liable for the \$75,000 tax liability.

If a purchaser asserts that liens superior to the state's liens consumed some or all of the proceeds of the sale, it is the purchaser's responsibility to identify other secured interests, prove the amount that was paid, and demonstrate that they are superior¹⁰ to the state's lien(s) under MCL 205.29(1). Federal tax liens are superior to the state's liens if the recorded federal lien interest precedes the state's.¹¹ The proceeds from the sale of the business must actually be applied to the superior lien for it to reduce the liability.¹²

Example 12: ABC purchases XYZ and fails to comply with the escrow requirement. ABC is assessed \$100,000 as a successor. ABC asserts that DEF had a lien in the amount of \$20,000 in favor of it superior to the State's lien against XYZ. However, none of the proceeds from the transaction between ABC and XYZ were paid to DEF. ABC's liability is not reduced; it is liable for \$100,000.

¹⁰ The general rule regarding lien priority is "first in time, first in right," but exceptions apply. Taxpayers should consult with a tax professional to determine priorities.

¹¹ Assessment dates are determined by 26 CFR 301.6203-1, MCL 205.21, and MCL 205.24.

¹² *P.J. Hospitality, Inc. v Dep't of Treasury*, 306 Mich App 479 (2014).