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## Texas Successor Liability: A Trap For The Unwary

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### The Trap. . .

In Texas, when a business owing Texas tax is purchased by another business, the purchaser is required to withhold an amount of the purchase price sufficient to pay the taxes due.<sup>1</sup> Failure to withhold makes the purchaser liable for the taxes, penalty and interest owed by the seller up to the purchase price paid for the business.<sup>2</sup> If purchaser receives a tax clearance certificate prior to the purchase, the obligation to withhold terminates.<sup>3</sup>

### Is Sprung!

In a recent decision, the Texas Comptroller upheld an auditor's sales and use tax assessment, pursuant to the successor liability statute, against a purchaser even though purchaser did not directly pay seller, a debtor under federal bankruptcy protection, for the business.<sup>4</sup>

### Facts

In March 2003, Purchaser contracted with Seller to purchase all the goodwill, trade names, menus, recipes, and the spices, chemicals, foodstuffs, and alcoholic beverages remaining on the premises at Seller's location in Texas. Prior to the execution of the agreement, Seller had closed the restaurant, and the landlord took possession of the premises and its contents. The purchase agreement provided that in order for Purchaser to get the employees to continue to work at the restaurant, Purchaser would pay the payroll amounts owed to Seller's employees with any sums remaining to be paid to Seller's creditors. That same day, Purchaser executed a lease for the premises with the landlord and reopened the restaurant under the same name used by Seller. At the time of its agreement with Seller, Purchaser did not request a tax clearance certificate from the Comptroller.

<sup>1</sup> Tex. Tax Code Ann. § 111.020(a).

<sup>2</sup> Tex. Tax Code Ann. § 111.020(b).

<sup>3</sup> Tex. Tax Code Ann. § 111.020(c).

<sup>4</sup> Texas Comptroller Decision, Hearing No. 43,810, STAR No. 200501045H (January 24, 2005).

In May 2003, the Comptroller calculated but did not bill Seller for the audit period January 1, 2001 through March 19, 2003, apparently because Seller filed for bankruptcy protection. On June 11, 2003, Purchaser was assessed, pursuant to the successor liability statute, for sales and use tax owed by Seller for the audit period.

## **Analysis**

At the heart of the decision is the question of whether Purchaser acquired a business from Seller even though Seller was not operating the business at the time of the sale and the Seller did not receive any payments under the purchase agreement.

Purchaser argued that it did not purchase a business since Seller had lost its lease, had its assets confiscated by the landlord, and had closed the restaurant. In addition, Purchaser argued that Seller received no payments from Purchaser. Rather, Purchaser paid Seller's employees and creditors.

In furtherance of its argument that it did not acquire a business, Purchaser cited Comptroller Decision No. 30,262 in which the Comptroller held that the mere purchase of a trade name which was subsequently altered did not subject the Purchaser to successor liability.<sup>5</sup> Additionally, Purchaser cited Comptroller Decision No. 40, 882 holding that the assumption of a lease, purchasing the primary items required to run a restaurant, along with the trade name, was sufficient for successor liability.<sup>6</sup> Purchaser argued that it had purchased only the trade name and had not assumed Seller's lease for the premises and had not purchased the assets necessary to operate a restaurant.

In holding that Purchaser did acquire a business, the Comptroller pointed to the purchase agreement which stated that Purchaser bought the trade name, goodwill, menus, recipes, etc. of the restaurant. Moreover, the Comptroller stated that given the totality of the circumstances, including the fact that Purchaser operated under the same name with the same employees at the same location, the transaction was in effect a purchase of the business of the restaurant. The payments made to the employees and creditors, the Comptroller determined, were consideration for the purchase of the business because they mitigated Seller's liabilities to the extent of the payments.

Finally, the Comptroller held that since Purchaser did acquire Seller's business and since Purchaser did not request a tax clearance certificate at the time of its purchase, Purchaser was liable for the amount owed by Seller to the extent of the purchase price.

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<sup>5</sup> Texas Comptroller Decision, Hearing No. 30,262, STAR No. 9403080H (March 2, 1994).

<sup>6</sup> Texas Comptroller Decision, Hearing No. 40,882, STAR No. 200209636H (September 20, 2002).

## Trap Avoidance: How Not To Pay Twice For The Same Business

Given the Comptroller's ever expanding definition of what constitutes a business,<sup>7</sup> the safest way for a buyer to avoid the successor liability trap is to request a tax clearance certificate from the Comptroller before the purchase of a business, or the assets of a business, is completed. When the Comptroller receives a request for the tax clearance, she has a maximum of 90 days to audit Seller's books and issue the certificate.<sup>8</sup> If the certificate is not issued within the 90-day period, the buyer is released from any withholding obligation or liability.<sup>9</sup>

If a tax clearance certificate cannot be obtained, the buyer should carefully analyze the seller's state tax liabilities and withhold a sufficient amount from the purchase price to pay the potential tax liabilities. Although successor liability may not be contracted away and the Comptroller may still take enforcement action against buyer, if seller objects to the withholding, the buyer should require seller to agree to indemnify buyer or provide other security for any tax liability related to seller's operation of the business.

If seller is financially distressed and has sought or is contemplating seeking bankruptcy protection, buyer should purchase the business or assets of the business from the bankruptcy trustee. Texas Comptroller rules provide that sale of a business by a bankruptcy trustee is not a sale by the former owner, and buyer will not incur successor liability.<sup>10</sup>

Acquiring a business, or the assets of a business, requires careful analysis of the costs relative to the return on the assets acquired. Paying the acquisition price twice rarely will lead to a profitable venture. By obtaining a tax clearance certificate from the Comptroller prior to a purchase, buyers can avoid the Texas successor liabilities trap.■

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<sup>7</sup> 34 TAC § 3.7(d). A "business" may be sold if an owner sells: (1) a building, land, furniture, fixtures, inventory, and the right to use the seller's trade name; (2) all the capital assets of the business; (3) the name and goodwill of a business; (4) all the inventory of a business; or (5) fixed assets and realty necessary to operate a similar business as the seller at the same location.

<sup>8</sup> Tex. Tax Code Ann. § 111.020(c).

<sup>9</sup> Tex. Tax Code Ann. § 111.020(d).

<sup>10</sup> 34 TAC § 3.7(h).



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