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THE NEW APPLICATION OF TRANSFEREE LIABILITY

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OVERVIEW

- **Code Provisions for Transferee Liability**
- **Fraudulent Transfer Laws**
- **Key Issues for Tax Liabilities**
- **The Intermediary (“Midco”) Transaction Tax Shelter**
- **Recent Decisions**

SECTIONS 6901 TO 6905

- **Allows the IRS to use normal administrative processes to collect from transferees**
- **Applies only to income, gift, or estate taxes**
- **The Code doesn't determine actual liability – the liability is a result of contract, fraudulent transfer laws, or the “trust fund” doctrine**
- **Statute of limitation provisions; judicial review; burden of proof**

FRAUDULENT TRANSFER LAWS

- **Actual fraud**
- **Constructive fraud**
- **Transfers in contemplation of insolvency**
- **“Insider” fraud**
- **Defense – the transferee took the property in good faith and for reasonably equivalent value**

KEY ISSUES – TAX LIABILITIES AND THE MIDCO TRANSACTION

- **Is the tax liability a present claim or a future claim?**
- **Is the tax liability included in determining whether the transferor is insolvent?**
- **Was there a transfer?**

HOW TO SELL A BUSINESS

- **Shareholders sell stock to buyer**
 - No double tax
 - But buyer doesn't get stepped-up basis in assets, and may be exposed to target's liabilities

OR

- **Corporation sells assets to buyer and then liquidates**
 - Buyer gets stepped-up basis in assets
 - But double tax

THE SOLUTION – MIDCO TRANSACTION

- **Step one – shareholders sell stock in target to midco, at price that does not reflect the corporate level tax for sale of assets**
- **Step two – target sells assets to buyer, who gets stepped-up basis**
- **Step three – midco withdraws cash**
- **Step four – midco/target avoids, offsets, or does not pay the corporate level tax for sale of assets**

CURRENT DEFINITION – NOTICE 2008-111

- **Built-in tax, due to low basis assets**
- **At least 80% of the stock is disposed of, other than in liquidation, within 12 month period**
- **At least 65% of the assets are sold within a year of (before or after) the stock sale**
- **At least half of the built-in tax is offset, avoided, or not paid**

RECENT DECISIONS

- *LR Development Company* – taxpayer wins
- *CHC Industries, Inc.* – government wins
- *Griffin* – taxpayer wins
- *Starnes* – taxpayer wins

LR DEVELOPMENT COMPANY

- **Purported transferee was buyer**
- **Court agreed that the target company did not receive reasonably equivalent value, and was insolvent as a result of the transfer**
- **But the government did not provide evidence of the promoter's intent and belief about incurring debts beyond its ability to pay; that is, was it reasonable to believe the tax on the asset sale could be eliminated?**

CHC INDUSTRIES, INC.

- **Purported transferee introduced the seller to the promoter**
- **Received payment for finders fee from the target, not the promoter**
- **Petitioner argued that the payment should be treated as coming from the promoter, not the target, but did not dispute whether the target should have reasonably believed it would incur debts beyond its ability to pay**

GRIFFIN

- **Clear and undisputed transfers to the seller**
- **Government did not demonstrate that transfers were for less than reasonably equivalent value and caused insolvency**
- **Keys**
 - **Promoter's contractual liability to pay taxes**
 - **Promoter's note**

STARNEs

- **Promoter paid shareholders for the stock and withdrew cash from the target**
- **Was that the same as a transfer from the target to the shareholders?**
 - **Agreement: at closing, deliver target's cash to promoter, or as promoter directs**
 - **Standard: constructive knowledge ("the entire scheme"), or objective economic reality?**
- **On appeal to the Fourth Circuit**

WHERE WE STAND TODAY

- Taxpayers have won most of the cases
- But transferee liability still has teeth – some results were due to unusual circumstances or litigation strategy
- Keys
 - Existence of a transfer (*Starnes*)
 - Reasonably equivalent value
 - Good faith/promoter's intent and belief