

Successor Liability for Taxes: *ACI Construction*

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When a business entity is struggling to pay tax debts or other obligations, and someone proposes the transfer of its assets to a new entity owned by the same or related owners, one may ask whether the prior entity's obligations will be enforceable against the new one. The potential for enforcement of a transferor's tax obligations against its transferee is demonstrated by *ACI Construction, LLC v. United States*, 130 AFTR 2d 2022-5882, a recent decision of the Federal District Court of Utah.

Facts in *ACI Construction*

Sid Crookston, LLC (also known as Sid Crookston Construction, "SCC") was engaged for many years in a construction business involving improvements commonly made in connection with subdivision of land. The sole owner of SCC was Sid Crookston ("Sid"), but his two sons and stepson were also active in the business and eventually served the company in leadership roles.

By early 2016, SCC was burdened by obligations attributable to lawsuits or threats of litigation regarding at least three projects and by more than \$1,400,000 of unpaid Federal tax obligations. As a result, SCC shut down in or about July 2016. No detail is provided in this decision, or related earlier reported proceedings, as to the origins of the tax obligations, but it appears that, prior to the decision discussed below, judgment had been entered against SCC in respect of those obligations (see *ACI Construction, LLC v. United States*, 128 AFTR 2d 2021-7020 (D. Ct. Ut.))

Sid's sons and son-in-law formed ACI Construction, LLC ("ACI") contemporaneously with the shut-down of SCC. ACI took possession of at least some of SCC's equipment, used SCC's email address and physical location, and continued work on projects that had been commenced by SCC. At least 22 of SCC's employees became employees of ACI, customers of SCC became customers of ACI, and at least one of SCC's contractual obligations with a supplier was assumed by ACI.

The decision states that, although Sid was not a "formal" owner of ACI, he acted as a supervisor on ACI's projects from the time of its formation, became an employee of ACI in 2017, represented ACI in meetings with customers, and made decisions on behalf of ACI. In addition, evidence before the court indicated that Sid's wife received a higher salary than the sons and son-in law of Sid who were, at least in form, the owners of ACI.

In 2019, the United States asserted that ACI was liable for tax obligations of SCC as SCC's successor in interest and filed a lien against the property of ACI on that basis. ACI sued to quiet title to its property, and the United States filed a counterclaim to seek a determination that ACI was liable for SCC's tax obligations. ACI moved for summary judgment to quiet title to its property and on the counterclaim of the United States.

Discussion

The court viewed the key issue, in respect of ACI's motion for summary judgment, as being whether the United States had produced evidence (sufficient to defeat ACI's motion) that ACI was SCC's successor in interest. The decision notes that, in the context of the motion for summary judgment, the court was required to construe the evidence before it in the light most favorable to the United States as the nonmoving party, to determine if the evidence could establish the existence of the elements necessary to a finding of successor liability.

It was apparently undisputed that the state law of Utah was controlling on this issue. Under Utah law, as summarized by a case cited in the decision, successor liability would not apply in respect of a transfer of the assets of one company to another unless: (1) the transferee expressly or implicitly agrees to assume the debts of the transferor, (2) the transaction "amounts to" a consolidation or merger of the transferor and transferee, (3) the transferee is "merely a continuation" of the transferor, or (4) the transfer is entered into fraudulently to avoid liability for debts of the transferor.

SCC retained ownership of construction machinery and vehicles that were encumbered by loans from a bank, and ACI argued that this circumstance established that ACI had not acquired all or substantially all of SCC's property and, therefore, that successor liability could not apply.

However, evidence before the court indicated that ACI took possession of equipment of SCC and assumed SCC's obligations with respect to equipment rentals, which undermined the argument that ACI had not acquired substantially all the assets of SCC. There was also evidence that ACI continued projects of SCC, that customers of SCC became customers of ACI, that ACI used SCC's email address and physical location, and that ACI benefited from SCC's goodwill. The court therefore concluded that there was sufficient evidence such that a fact-finder might conclude that SCC transferred all or substantially all of its assets to SCC.

The transfer of all or substantially all of the assets of one entity to another would not in itself support a finding of successor liability under Utah law, unless at least one of the four circumstances listed above also applied. However, the decision further concludes that the United States had provided sufficient evidence that the transfer amounted to a consolidation or merger (more specifically, a "de facto" merger) of the two companies, and that the acquiring company was merely a continuation of the transferor.

In respect of whether there had been a de facto merger of SCC and ACI, the decision stated (citing case law from Utah and other jurisdictions) that a finding of such a merger generally turns on four factors: continuity of the enterprise in respect of management, personnel, physical location, assets and operations; continuity of ownership; cessation of operations of the transferor; and assumption of obligations of the transferor by the transferee necessary to continue the business.

The strongest counter-argument of ACI in respect of these four factors appeared to be on the basis of continuity of ownership. ACI asserted that a finding of de facto merger was precluded by the circumstance that Sid, the sole owner of SCC, was not an owner of ACI. The decision states, however, that it was necessary for the court to look beyond “surface level formalities,” and that Sid’s assertions of authority over management-level decisions of ACI, the familial relationship between him and the owners in form of ACI, and the circumstance that Sid’s spouse was paid a larger salary than the nominal owners lead to a reasonable inference that Sid “had a significant interest in the success and well-being of ACI and was, in substance, an owner of ACI.”

The court further concluded that there was sufficient evidence of the other factors of a de facto merger (continuity of the enterprise, termination of the operations of the transferor, and assumption of obligations) such that a reasonable fact-finder could conclude that such a merger had occurred.

Unsurprisingly in light of the above, the decision further concludes that there was sufficient evidence to raise a reasonable inference that ACI was a “mere continuation” of SCC, taking into account the continuation of ownership within the same family, commonality of management, and continuity in respect of employees, assets, customers, e-mail address, physical location, operations, and contractual obligations.

Consequently, the court concluded that, overall, there was sufficient evidence to permit a reasonable fact-finder to conclude that ACI was SCC’s successor in interest and, as a result, liable for the tax obligations of SCC, and ACI’s motion for summary judgment was denied.

Observations

There is no finding in the decision in respect of the motivation of Sid, his sons and son-in-law in shutting down SCC and forming ACI, and the decision is not a final determination as to whether, in fact, ACI was liable for the tax debts of SCC as the successor in interest to SCC. The decision does, however, confirm that the Federal government is well aware of state laws pertaining to successor liability, and prepared to seek to apply them, in combination with the filings of liens and the use of other collection tools authorized under the Internal Revenue Code, to collect from a successor entity tax obligations of its predecessor.

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