

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **200840001**

Release Date: 10/3/2008

CC:PA:04

GL-130545-08

UILC: 6321.00-00

date: August 28, 2008

to: Richard T. Cummings
General Attorney (Hartford)
(Small Business/Self-Employed)

from: Peter J. Devlin
Chief, Branch 4
(Procedure & Administration)

subject: Successor Liability

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

May the IRS rely on the state law doctrine of successor liability to collect a corporation's or LLC's federal tax liability from its successor in interest?

CONCLUSION

Yes. A federal tax liability owed by a corporation or LLC may be collected from its successor in interest if the successor corporation or LLC is liable under the relevant state law.

LAW AND ANALYSIS

I. Successor Liability

Generally, a corporation that acquires the assets of another corporation is not liable for the debts of the transferor corporation. This general rule is subject to certain exceptions. Successor liability law embodied in most jurisdictions imposes liability in the following circumstances: (1) when the successor expressly assumes the liabilities; (2) when the transaction amounts to a de facto merger; (3) when the successor is a mere continuation of the seller corporation; and (4) when the transaction is entered into fraudulently to escape liability. See William M. Fletcher, *Fletcher Cyclopedic of the Law of Corporations* § 7122 (2007). The government may rely on the successor liability doctrine to hold a successor corporation liable for the tax debts of its predecessor. See *Atlas Tool Co. v. Commissioner*, 614 F.2d 860, 871 (3d Cir. 1980).

Successor liability is generally determined by state law. *LiButti v. United States*, 178 F.3d 114, 124 (2d Cir. 1999). For example, Connecticut, like most jurisdictions, recognizes the successor liability doctrine and the four theories imposing liability. *Collins v. Olin Corp.*, 434 F. Supp.2d 97, 102 (D. Conn. 2006). The mere continuation and de facto merger theories are closely related and may be considered together. *Id.* at 104. Connecticut courts look to the following factors when considering whether a corporation is liable under the mere continuation or de facto merger theories:

- (1) continuation of the enterprise of the seller corporation so that there is a continuity of management, personnel, physical location, assets and general business operations;
- (2) continuity of shareholders;
- (3) the seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible;
- (4) the purchasing corporation assumes those liabilities and obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.

Presence of all indicia is not necessary; Connecticut courts balance the factors in a “flexible, realistic manner, focusing on intent.” *Id.* at 103 (citing *Savings Bank of Manchester v. Daly*, 2004 WL 3130581, at *3 (Conn. Super. Ct., Dec. 23, 2004)). An LLC has been found liable as a successor under Connecticut law. *C & J Builders and Remodelers, LLC v. Geisenheimer*, 733 A.2d 193 (Conn. 1999).

We emphasize the necessity of consulting state law when considering successor liability. While most jurisdictions have adopted the four theories imposing successor liability, courts have not uniformly applied the theories. We note that successor liability is not equivalent to alter ego or nominee liability. Common facts and circumstances may establish liability under the respective theories, but the three doctrines are separate and distinct.

II. LLC Successor Liability for Employment Taxes

Your request for advice addresses collection of employment tax liabilities from LLCs using the successor liability doctrine.

1. Single Member LLC & Employment Tax Liability

A single member LLC may elect to be treated as an association taxable as a corporation. Treas. Reg. § 301.7701-3(a). If an LLC elects corporate status, the LLC will be treated as a separate legal entity that may accrue its own tax liability. The IRS may collect such liability from the assets of the LLC; if the LLC transfers its assets to another entity, successor liability may apply under the relevant state law.

A single member LLC is a disregarded entity if it makes no election. Treas. Reg. § 301.7701-3(b)(1)(ii). A disregarded entity is not separate from its owner for federal tax purposes. A recent amendment to the Treasury Regulations effective January 1, 2009, modifies the treatment of disregarded entities for purposes of employment tax obligations.

A. Wages Paid by a Disregarded LLC Before January 1, 2009

Employment tax liabilities with respect to wages paid before January 1, 2009, by a disregarded LLC may be satisfied in one of two ways. The single member owner may calculate, report, and pay the employment tax obligation under its own name and taxpayer identification number. Alternatively, the disregarded LLC may separately calculate, report, and pay the employment tax obligations incurred with respect to the employees of the LLC under the name and taxpayer identification number of the LLC. Notice 99-6, 1999-3 I.R.B. 12, 1999-1 C.B. 321.

The single member owner of a disregarded LLC retains ultimate responsibility for employment tax liabilities incurred with respect to wages paid before January 1, 2009, regardless of the method selected under Notice 99-6. Collection of such tax liability may be pursued against the single member owner's property and rights to property. I.R.C. §§ 6321; 6331. The United States Supreme Court has articulated a two-part test to determine a taxpayer's property and rights to property. Drye v. United States, 528 U.S. 49, 58 (1999). First, a taxpayer's interest or rights must be determined under state law. Second, whether such interest or rights are property or rights to property under the Internal Revenue Code must be determined. State law generally provides that a member of an LLC has no interest in the LLC's assets. The IRS cannot satisfy a single member owner's tax liability from the disregarded LLC's assets because the single member owner has no property or rights to property in the LLC's assets. Therefore, when a disregarded LLC transfers its assets, successor liability does not apply because the single member owner has no interest in the LLC's assets. If, however, a single member owner transfers its assets to another entity, successor liability may apply depending on state law.

B. Wages Paid By a Disregarded LLC On or After January 1, 2009

On January 1, 2009, Treas. Reg. § 301.7701-2(c)(iv) becomes effective and Notice 99-6 becomes obsolete. The amended regulation treats a disregarded LLC as separate from its owner for purposes of employment tax liabilities arising with respect to wages paid on or after January 1, 2009. A disregarded LLC is taxed as a corporation for employment tax purposes and many of the issues surrounding collection of a tax liability from a disregarded LLC are eliminated. Collection against the LLC may be pursued as if it were a corporation; if an LLC transfers its assets to another entity, successor liability may apply under the relevant state law.

2. Multi-Member LLC & Employment Tax Liability

A multi-member LLC may elect to be treated as an association taxable as a corporation. Treas. Reg. § 301.7701-3(a). If an LLC elects corporate status, the LLC will be treated as a separate legal entity that may accrue its own tax liability. The IRS may collect such liability from the assets of the LLC; if the LLC transfers its assets to another entity, successor liability may apply under the relevant state law.

A multi-member LLC is treated as a partnership if it makes no election. Treas. Reg. § 301.7701-3(b)(1)(i). State law generally provides that a member of an LLC is not liable for the LLC's debts. If an LLC incurs an employment tax liability as a partnership, the IRS cannot collect an employment tax liability from the LLC's members even though the LLC is treated as a partnership for federal tax purposes. Rev. Rul. 2004-41. Collection of a tax liability is pursued against the partnership's assets. If permitted by state law, successor liability may be asserted when a multi-member LLC taxed as a partnership transfers its assets to another entity. See generally Graham v. James, 144 F.3d 229, 240 (2d Cir. 1998) ("The traditional rule of corporate successor liability and the exceptions to the rule are generally applied regardless of whether the predecessor or successor organization was a corporation or some other form of business organization.").

We note that the trust fund recovery penalty under I.R.C. § 6672 may be asserted against members of an LLC treated as a corporation or partnership depending on the facts and circumstances of the case. Also, special circumstances such as a fraudulent transfer of assets from the LLC to its members may expose members to liability. See generally Scott v. Commissioner, 236 F.3d 1239 (10th Cir. 2001) (imposing transferee liability under I.R.C. § 6901 on person receiving fraudulent transfer of assets from taxpayer-corporation).

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-3630 if you have any further questions.