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# Watch Out for Successor Liability

By Stuart M. Bordman

Attorneys and accountants know that when a purchaser buys the stock of a corporation, except to the extent otherwise provided in the stock purchase agreement, all of the assets and liabilities of the corporation come with the stock. With respect to an asset purchase, the purchaser acquires only those assets and assumes only those liabilities set forth in the Asset Purchase Agreement (“APA”). Notwithstanding the terms and conditions of the APA, a purchaser of an entity that does business in Michigan may be subject to liabilities not disclosed in the APA. This article identifies certain hidden liabilities and suggests actions to avoid the same.

As a first step, the purchaser should conduct a UCC Search of the target entity in the state in which the seller is organized and a lien search in the county in which the target does business. The searches should list security interests and liens to which the assets of the target are subject.

Even if the searches reveal no State of Michigan tax liens, the purchaser may have liability as a successor to the seller.

## Successor Liability

MCL 205.27a (“27a”), amended and effective February 6 2014, provides in part<sup>1</sup>:

If a person liable for a tax administered under this act<sup>2</sup> sells out his or her business or its stock of goods or quits the business, the person shall make a final return within 15 days after the date of selling or quitting the business. 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. Upon the owner’s written

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waiver of confidentiality, the department shall, within 60 days of receipt of the request, release to a purchaser a business's known or estimated tax liability for the purpose of establishing an escrow account for the payment of taxes. The department may estimate tax liability based on prior returns and payments. If the department believes that a return made or payment does not supply sufficient information for an accurate determination, the department may make an estimate based on other available information. 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 taxes, interest, and penalties accrued and unpaid by the business of the former owner. If the purchaser or succeeding purchasers of a business or its stock of goods comply with the escrow requirements of this subsection, the purchaser shall not be held liable for more than the known or estimated tax liability disclosed by the department and held in escrow. However, the purchaser shall not be held liable if the department has failed to provide the information requested within 60 days. For a purchaser or succeeding purchaser that has not complied with the escrow requirements of this section, the purchaser's or succeeding purchaser's personal 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 lien provided for in section 29(l).

## **Procedure**

To follow the procedure set forth in 27a, the purchaser or seller must complete the Michigan Department of Treasury ("Treasury") Form 5156, Request for Tax Clearance Application. While the Act states the department shall, within 60 days of receipt of the request, release to a purchaser a business's known or estimated tax liability, there is no reference to the 60 day period in the instructions to Form 5156. If the seller does not make the request, the same can be made by another party who submits a Limited Power of Attorney (Form 3840) along with the

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application.

If the purchaser receives the estimated tax liability from Treasury and places that amount in escrow, the purchaser will not be liable for an amount in excess of the amount held in escrow.

Post closing, the seller will obtain a Tax Clearance Certificate (the “Certificate”) from Treasury and upon delivery of the Certificate, the amount in escrow can be paid to the seller if there is no tax due or used to pay any tax which is due. In either event, there should be no further exposure to the purchaser.

### **Alternatives to the Request for Tax Clearance**

*What do you do if the purchaser and seller want to close the transaction before the end of the 60 day period?*

Certainly the purchaser’s accountant should confirm that all returns for sales, use, withholding, etc. have been filed and that the seller has paid all taxes due. While the accountant’s investigation may provide some comfort to the purchaser, further steps are necessary.

If the transaction is for cash, a sufficient amount of the purchase price (based upon the accountant’s analysis) should be placed in escrow to cover any tax liability until the seller delivers a Certificate. The Certificate may not be available until the seller has filed its final tax return. Accordingly, it may be several months or a year or more before the seller is able to produce a Certificate.

If the purchase price is being paid over time, the purchaser may not be concerned with an escrow arrangement<sup>3</sup>. The purchaser may be satisfied with the right of offset against the next payments due in the promissory note for any tax liabilities which the purchaser must pay on behalf of the seller. The APA should provide that the seller will deliver a Certificate by a specified date, and if by that date the Certificate is not delivered, future installments will be placed in escrow until the escrow reaches a specified amount and such amount will be retained in escrow until the seller delivers the Certificate.

### **Unemployment Insurance Agency**

MCLA 421.15(g) provides that if an “employing unit” acquires the trade or

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business of an “employing unit” the purchaser will be liable for contributions and interest owed by the transferor. The transferor or transferee not less than 10 days before the acquisition can request a statement certifying the amount owed by the transferor and the transferee is not liable for an amount in excess of the amount certified.<sup>4</sup>

The accountant for the purchaser should follow the same procedures regarding UIA liability as he follows regarding sales, use and withholding taxes. If a certification from the UIA is not obtained, the same or a separate escrow should be established to cover liability to the UIA. The triggering mechanism for distribution from the escrow is delivery by seller to purchaser of Form UIA-1395, Clearance of Account.

## **Representations and Warranties**

In the APA, the seller should warrant and represent that all returns have been filed with Treasury and the UIA; all taxes have been paid and all contributions have been made. The warranty and representation should not expire until the statute of limitations has expired.

## **Indemnification**

The shareholders of the seller or the members of the seller (if the seller is an LLC) should personally agree to indemnify, defend and hold the purchaser harmless from any breach of warranty with respect to payment of taxes or UIA contributions.

## **Conclusion**

Representations, warranties and indemnification are only a backstop and not a substitute for the due diligence and escrow procedures discussed above.

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<sup>1</sup>27a should be reviewed in its entirety.

<sup>2</sup>The act is entitled “Revenue Collection by the Department of Treasury”.

<sup>3</sup>The author represented a seller in an asset sale to an entity represented by a non-Michigan attorney. The issue of a tax clearance or an escrow was never raised.

<sup>4</sup>

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This process is separate from Form UIA-1027, Business Transferor's Notice to Transferee of Unemployment Tax Liability and Rate, which must be delivered by the seller to the purchaser at least two calendar days before the transferor's acceptance of the transferee's offer to acquire the business.

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