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Ninth Circuit: Transferee liability, asset sale followed by stock sale

The U.S. Court of Appeals for the Ninth Circuit today reversed a decision of the U.S. Tax Court, and remanded with instructions to enter judgment for the IRS Commissioner. The case involved an assessment for transferee liability when there was an asset sale followed by a stock sale.

The case is: *Slone v. Commissioner,* No. 16-73349 (9th Cir. July 24, 2018). Read today's Ninth Circuit's **decision** [PDF 120 KB]

Summary

The taxpayer sold its assets to a second company, and then the taxpayer's shareholders sold their shares to that same company which then changed its name and was later administratively dissolved for failure to file an annual report.

The IRS sent notices of tax liability to the taxpayer's former shareholders, with the IRS claiming that the shareholders were liable as "transferees" for taxes owed on the taxpayer's asset sale. The IRS asserted it could disregard the form of the stock sale because the substance of the transaction was that the taxpayer dissolved upon selling its assets, then distributed those assets to its shareholders through the stock sale.

The Tax Court initially determined that the stock sale was a legitimate transaction and that the transaction must be respected.

On appeal, the Ninth Circuit (in 2015) held that the Tax Court had applied an incorrect test in making its determination. The Ninth Circuit found that when the IRS claimed a taxpayer was "the shareholder of a dissolved corporation" for purposes of section 6901, but the taxpayer did not receive a liquidating distribution if the form of the transaction is respected, a court must consider the relevant subjective and objective factors to determine whether the formal transaction "had any practical economic

effects other than the creation of income tax losses." The Ninth Circuit remanded the case to the Tax Court, with instructions to apply the test set forth in *Commissioner v. Stern,* 357 U.S. 39 (1958).

Stern requires that a two-pronged test be satisfied for a tax liability to be imposed on a transferee under section 6901: (1) the first prong is satisfied if the party is a "transferee" under section 6901 and federal tax law; and (2) the second prong is satisfied if the party is "substantively liable for the transferor's unpaid taxes under state law."

On remand, the Tax Court in 2016 found that under applicate state law (Arizona which had enacted the Uniform Fraudulent Transfer Act (UFTA)), there was no actual fraud. Since the Tax Court found that under *Stern,* the state law prong had not been satisfied, it did not analyze the federal law prong of the test.

Today, the Ninth Circuit reversed. The Ninth Circuit found that in applying the UFTA, the transaction was "constructively fraudulent" as to the IRS because the taxpayer did not receive a reasonably equivalent value in exchange for the transfer to its shareholders and was left unable to satisfy its tax obligation. The appeals court further explained that the sale to the second company was a cash-for-cash exchange lacking "independent economic substance beyond tax avoidance" and that "reasonable actors … would have been on notice that the [second company] never intended to pay … [the taxpayer's] tax obligation."

Direct comments, including requests for subscriptions, to Washington National Tax. For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at + 1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.