The Wayfair Decision – Heightened Risk of Successor Liability in Asset Transactions

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ROMAN A. BASI

ROMAN A. BASI IS AN EXPERT ON CLOSELY HELD ENTERPRISES. HE IS AN ATTORNEY/CPA AND THE PRESIDENT OF THE CENTER FOR FINANCIAL, LEGAL & TAX PLANNING, INC.

The recent Supreme Court Decision - *South Dakota v. Wayfair, Inc.,* – has dramatically impacted online retailers and increased possible successor liability risks in terms of Merger and Acquisition (M&A) transactions. Prior to the *Wayfair* ruling, the "physical presence" standard set out in *Bellas Hess* and *Quill* controlled online retailers' necessity to pay South Dakota sales tax. *National Bellas Hess, Inc. v. Department of Revenue of Ill.,* 386 U.S. 753 (1967) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). The Physical Presence rule allowed out of state retailers who sell their products or services online to avoid the states sales and use taxes due to a lack of actual, physical presence of the business in the state. However, under the South Dakota Statute affirmed by the Supreme Court, online retailers are now required to pay South Dakota sales tax if their business has a "substantial nexus" with the state. *South Dakota v. Wayfair, Inc.,* 138 S. Ct. 2080, 2099 (2018). This is reached when the retailer has sold over $100,000 in in-state sales or completed over 200 transactions in the state on an annual basis. *Id*. at 2084.

Following the *Wayfair* decision over half of the states have developed and are implementing very similar requirements for out-of-state retailers selling goods online. The Supreme Court found that the physical presence standard not only incentivized the avoidance of state sales tax, but cost states an average of eight to thirty-three billion dollars per year in taxes. The physical presence standard is appropriately being phased out due to modern technological advances providing online retailers with the ability to reach virtually any United States consumer and avoidance of states' sales tax has become a multibillion-dollar issue.

The Supreme Court provides the test for sustaining the sales tax imposed by the State on online retailers, "The Court will sustain a tax so long as it (1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides." *Wayfair*, 138 S. Ct. 2080, 2091 (2018) (quoting *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977)). "[S]uch a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction.'" *Wayfair,* 139 S. Ct. 2080, 2099 (2018) (quoting *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1, 11 (2009)).

Now that we have an understanding of *Wayfair's* analysis as applied to online retailers performing out-of-state transactions, it's important to understand the sales and use tax liabilities in the context of buying or selling a business involved in online retail.

Successor liability in Light of the *Wayfair* Decision:

This increasing development of case law has led to more exceptions to the rule of buyer non-liability. The ABA published a memorandum in January of 2018 on successor liabilities in an asset transaction that has greatly increased its relevance in light of the *Wayfair* decision. In the memorandum, there are four exceptions of successor liabilities mentioned: (1) the buyer (successor) assumes the seller's liabilities expressly or impliedly; (2) the transaction in substance constitutes a merger or consolidation of the buyer and seller (*de facto merger*); (3) the buyer is "a mere continuation" of the seller; and (4) the intent of the transaction is to defraud seller's creditors. The most common of the four exceptions is the *de facto merger*. This exception is particularly influential if the transaction involves a continuity of management, general business operation and equity ownership, assumption of seller's ordinary course business liabilities, physical location, and seller's dissolution following the sale.

The question becomes, how do the successor liability standards above affect the buyer of a business that has online retail sales? If an online retailer does not follow the varying state-by-state requirements it could result in a failure of sales and use tax payments or payments of the incorrect amount. This may result in unforeseen liabilities when a creditor comes seeking repayment. The best way to avoid any potential successor liability issues is with vigilant due diligence and strategic pre-transactional planning focused on the abovementioned risk factors. A strong M&A team will greatly help limit any potential stress during a transaction that may result in a buyer withdrawing their interest due to successor liability. Due diligence focusing on specific state requirements regarding payment of sales taxes and the elimination of state tax liabilities prior to closing is key.

There are several other means to combat the risk of successor liability in addition to due diligence and pre-transactional planning. The two best strategies to avoid potential successor liability are the asset purchase agreement itself and the buyer remaining in existence after closing. An air tight asset purchase agreement ("APA") that expressly states which liabilities the buyer is willing to accept and which will remain with the seller will not completely absolve the buyer of liability, but will go a long way in limiting the risk of incurring such liabilities. The language in the APA should include the seller's obligation to indemnify the buyer for retained earnings and any non-assumed liabilities. The existence and viability of the seller after the life of the transaction offers two main protections: (1) seller can respond to post-closing indemnification claims made by the buyer and (2) the seller can then cover claims of other creditors who may come after any "successors" in the event of the selling entities dissolution. If possible, the buyer should require the seller to remain a viable entity, with the appropriate insurance policy, for any applicable limitations period.

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