

Cite as 2 WTD 53 (1986)

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>D E T E R M I N A T I O N</u>
For Correction of Notice of)	
Successorship Liability of	)	No. 86-304
)	
	)	Registration No. . . .
. . .	)	Notice of Successorship
	)	Liability dated
	)	January 27, 1986
)	
)	
	)	Registration No. . . .
	)	Tax Warrants No. . . . and
	)	No. . . .

- [1] **RULE 216, RCW 82.04.180 and RCW 82.32.140:** SUCCESSORSHIP -- MERCHANDISE - ACQUISITION. The acquisition of a predecessor's merchandise subjecting a taxpayer to successorship liability does not have to be by virtue of a direct conveyance or sale by that predecessor.
- [2] **RULE 216 and RCW 82.32.140:** SUCCESSORSHIP -- LANDLORD'S LIEN -- SUMMARY FORECLOSURE. Perishables and other products taken over and subsequently sold in accordance with the summary foreclosure provisions of chapter 60.10 RCW pursuant to the taxpayer's landlord's lien for unpaid rent were properly "acquired through regular legal proceedings to enforce a lien" and did not operate to render the taxpayer a successor, despite the fact that the taxpayer, in selling the goods, was operating a similar business in the same location. Taxpayer had made enough changes in the business so as not to be confused with the prior tenant.
- [3] **RULE 216 and RCW 82.32.140:** SUCCESSORSHIP -- LANDLORD'S LIEN -- FORECLOSURE -- TIMING. The provisions of Rule 216 do not prohibit foreclosure action which would cure successorship from occurring after a Notice of Successorship Liability is issued.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: May 19, 1986

NATURE OF ACTION:

The taxpayer was served with a Notice of Successorship Liability dated January 27, 1986, rendering it liable for amounts due on tax warrants previously issued to another taxpayer.

FACTS AND ISSUES:

Burroughs, A.L.J.--The Department of Revenue issued a Notice of Successorship dated January 27, 1986 to the taxpayer (hereinafter referred to as Corp A) imposing liability for payment of the above-referenced tax warrants totalling \$20,883.02 previously issued by the Department to its alleged predecessor (hereinafter referred to as Corp B). The taxpayer had sold petroleum products and operated a small convenience grocery store in the same location as had Corp B, its lessee, after regaining possession of the property following a default in lease payments. After some cleaning and alterations in the method of doing business, Corp A, after regaining possession of the store from the owners of Corp B, engaged in essentially the same activities.

TAXPAYER'S EXCEPTIONS:

Corp A protests the Department's conclusion that it is a successor under the law. Its petition dated March 17, 1986 outlines the facts and issues as follows:

The State of Washington Department of Revenue ("Department") issued ...[Corp A]... a "Notice of Successorship Liability" on January 27, 1986. In that notice, the Department asserted that ...[Corp A]... was a "successor," as defined in RCW 82.04.180, to the business which ...[Corp B]... operated at ..., Washington ("Premises"). The Department assessed against ...[Corp A]... ...[Corp B's]... unpaid sales tax. On February 13, 1986, ..., Chief of Interpretation and Appeals, granted ...[Corp A]... a 30-day extension to prepare and file this appeal of the assessment.

...[Corp A]. . . cannot be a successor to ...[Corp B]... under RCW 82.04.180 because (1) ...[Corp B]... did not sell or convey, directly or indirectly, any part of its materials, supplies, merchandise, inventory, fixtures, or equipment to ...[Corp A]..., and (2) even if ...[Corp A]... is held liable as a successor, it is relieved of any successorship liability pursuant to WAC 458-20-216. Additionally, the basis for computing the amount of ...[Corp B's]... tax deficiency appears to be incorrect and should ...[Corp A]... be liable for such tax deficiency, it requests the opportunity to review the documentation supporting the valuation of the deficiency. Accordingly, the assessment against ...[Corp A]... should be stricken and a correction entered to reflect the absolution of the assessment. ...[Corp A]... requests a conference to examine and review the assessment.

II.

FACTUAL BACKGROUND

A. Procedural History.

The Notice of Successorship Liability states that ...[Corp B]... owes unpaid taxes for the period May 1, 1985 through October 31, 1985. ...[Corp A]... first learned of ...[Corp B's]... purported tax liability in early November, 1985 when ...[a department representative]... contacted ...[Corp A's representative]... and informed him that ...[Corp A]... was being investigated as potentially having a "beneficial interest" in ...[Corp B's]... business pursuant to WAC 458-20-217. ...[Corp A]... fully cooperated with ...[the department's representative]... requests for information, including having its attorneys become involved in several telephone discussions with ...[the department's representative]... and [a Department] Deputy Attorney General regarding the Department's allegations.

On or about January 9, 1986, ...[Corp A]... was informed that the Department would not assess it for the tax liability pursuant to the "beneficial interest" regulation. The Department then informed ...[Corp A]... that it would be assessed for ...[Corp B's]... tax liability pursuant to the "successorship liability" statutes and regulations--RCW 82.04.180, RCW 82.32.140 and WAC 458-20-216. The Department alleged that

...[Corp A]... had taken over the ...[Corp B's]... business and subsequently sold merchandise which ...[Corp B]... had left in the Premises and thus became a "successor."

B. Summary of the Legal Relationships for the Property on Which ...[Corp B]... Operated.

The Premises on which ...[Corp B]... operated its business is subject to an underlying commercial lease, a sublease, and an assignment of the sublease. (All documents were delivered to ...[the department's representative]... in November, 1985.) The underlying commercial lease for the Premises is between ...[the owners of the property]..., as lessors, and ...[Corp A]..., as lessee. It commenced on April 1, 1983 and ends March 31, 2003.

...[Corp A]... subleased the Premises to ...[a second couple]... It commenced on May 1, 1983 and ends March 31, 2003.

On or about March 17, 1985, ...[the landowners]..., ...[Corp A]... and the ...[original sublessees]... assigned this leasehold interest to ...["Mr. and Mrs. John Doe" the ("the Does")]... and the ("Does")... assumed ...[original sublessees's]... obligations thereunder. ...[the original sublessees]... and ...[Corp A]... consented to such assignment. Apparently, ...[Corp B]... began operating its business at the Premises through an agreement with the ...["Does"]...

On July 1, 1985, ...[Corp A]... and the ...["Does"]... entered into a Commission-Agent Agreement whereby the ...["Does"]... agreed to remit receipts from the sale of gasoline at the Premises to ...[Corp A]... When the ...["Does"]... failed to fulfill this obligation and failed to pay rent to ...[Corp A]... under the sublease, ...[Corp A]... required the ...["Does"]... to issue ...[Corp A]... a note (dated September 5, 1985) for those obligations.

C. Status of ...[Corp A]...'s Complaint to Foreclose its Landlord's Lien Against the ["Does"].

...[Corp A]... filed its complaint against the ...["Does"]... to foreclose its landlord's lien on January 27, 1986. After several unsuccessful attempts to personally serve the ... ["Does"]..., ...[Corp A]...

initiated service by publication. Service by publication becomes effective April 25, 1986. In the meantime, ...[Corp A]... was able to serve the ...["Does"] personally on March 13, 1986.

III.

DISCUSSION

A. ...[Corp A]... Is Not a Successor to ...[Corp B]...

1. There Has Not Been a Sale or Conveyance From ...[Corp B]... to ...[Corp A]... .

The Department asserts that ...[Corp A]... is a "successor" to ...[Corp B]..., pursuant to RCW 82.04.180:

"Successor" means any person to whom a taxpayer quitting, selling out, exchanging, or disposing of a business sells or otherwise conveys, directly or indirectly, in bulk and not in the ordinary course of the taxpayer's business, a major part of the materials, supplies, merchandise, inventory, fixtures, or equipment of the taxpayer. Any persons obligated to fulfill the terms of a contract shall be deemed a successor to any contractor defaulting in the performance of any contract as to which such persons is a surety or guarantor.

(Emphasis supplied.)

The statute requires that ...[Corp B]... sell or convey its merchandise to ...[Corp A]... for ...[Corp A]... to be classified as a "successor." This did not happen.

...[Corp A]... leased the Premises to the ...["Does"]. When the ...["Does"] ... defaulted on their lease agreement and their Commission-Agent agreement, ...[Corp A]... took possession of the premises and held the merchandise therein for security for the payment of the ...["Does"]... liability to ...[Corp A]....

There has never been a sale or conveyance by the ...[Corp B]... to ...[Corp A].... The statutes and regulations relating to successorship liability address successor liability only in the context of a sale or conveyance of the merchandise of ...[Corp B]... to the person claimed by the Department to be the successor.

See, RCW 82.04.180, RCW 82.32.140, and WAC 458-20-216. The amount of ...[Corp B's]... liability to the Department is to be "withheld from the purchase price," by the successor. If the successor pays any of ...[Corp B's]... obligation to the Department, the payment is considered as "payment on the purchase price." WAC 458-20-216 lists eight factual situations to illustrate the application of successor liability. Seven of the eight illustrations involve purchase related factual situations.

...[Corp B]... neither sold nor in any manner conveyed its merchandise to ...[Corp A].... Rather, ...[Corp A]... seized the merchandise in the Premises as security for the failure of the ... ["Does"] ... to meet their contractual obligations to ...[Corp A]... It is apparent from the statutory and regulatory scheme that a successor is to be a person who participates in the sale, exchange or quitting of the ...[Corp B's]... business which results in the conveyance of the ...[Corp B's]... merchandise. That simply did not occur in this case.

2. Even if the Department Assumes the[Does]... and ...[Corp B]... to be One and the Same, a Point Which ...[Corp A]... Does Not Concede, ...[Corp A]... Is Relieved of Any Successorship Liability Pursuant to WAC 258-20-216.

WAC 458-20-216 provides in pertinent part:

The work [sic] "successor" includes all persons who acquire the taxpayer's equipment or merchandise in bulk, whether they operate the business or not, unless the property is acquired through insolvency proceedings or regular legal proceedings to enforce a lien, security interest, judgment, or repossession under a security agreement. The following factual situations illustrate the application of the foregoing:

. . . .

(5) Taxpayer leaves business, including fixtures and stock of goods which his landlord holds for unpaid rent. The landlord will be a successor unless he proceeds to foreclose his landlord's lien by posting notice and holding a sale by the sheriff.

(Emphasis supplied.)

...[Corp A]... has a landlord's lien for rent due from the ...["Does"]... pursuant to RCW 60.72. Such a lien may be foreclosed by the summary foreclosure provisions of RCW 60.10 or by the foreclosure provisions for personal property liens of RCW 61.12 RCW 60.72.020. The option to pursue one or both of these foreclosure remedies lies with the lienholder. ID.

In early October, ...[Corp A]... entered the Premises leased to the ...["Does"]... and took control of the merchandise therein to secure ...["Does"]... past due lease payment. An inventory of the merchandise was taken. Some of the merchandise was perishable, and some consisted of goods whose value decreased daily. ...[Corp A]... began its process of foreclosing its landlord's lien by disposing for the best price possible those perishable goods and those goods whose value declined on a daily basis. The remaining merchandise was stored. Failure of ...[Corp A]... to act in such a commercially reasonable manner to mitigate its damages would place the risk of loss of the value associated with such perishable or rapidly declining value merchandise on ...[Corp A]....

In furtherance of foreclosing its landlord's lien, ...[Corp A]... filed a complaint against the ...["Does"]... to foreclose the lien. After several attempts to personally serve the ...["Does"]... failed, ...[Corp A]... initiated service by publication. Eventually, the ...["Does"]... were personally served.

...[Corp A]... is proceeding to secure a judgment. Since there is no agreement with the ...["Does"]... allowing for a private sale, without such judgment it is not possible to hold the sheriff's sale. Once the judgment is obtained, ...[Corp A]... will sell the merchandise seized. After completing the legal proceedings, ...[Corp A]... will have foreclosed its landlord's lien through regular legal proceedings. This procedure relieves ...[Corp A]... from any successorship liability pursuant to WAC 458-20-216.

There is no specific time requirement for proceeding with the foreclosure. ...[Corp A]... is proceeding in a reasonable manner to foreclose its lien.

IV.

CONCLUSION

...[Corp A]... is not a successor under RCW 82.04.180 because ...[Corp B]... did not sell or otherwise convey any of its materials, supplies, merchandise, inventory, fixtures or equipment to ...[Corp A]... . In addition, if the ...["Does"]... and ...Corp B]... were considered one and the same, which is not conceded, ...[Corp A]... cannot be a successor because ...[Corp A]... proceeded under WAC 458-20-216 to foreclose its landlord's lien.

The assessment against ...[Corp A]... for ...[Corp B]... should be absolved in toto and a correction entered to reflect this absolution.

At the hearing, testimony was received that the corporation whose assets Corp A later purchased originally entered into a long-term lease agreement with the landowners in April of 1983. That corporation subleased the property to the original sublessee a month later. The original sublessee sold the business to the "Does", and an assignment of the lease with the consent of the landowners and Corp A, which by then had acquired the original leasehold interest was accomplished in March 1985. The "Does", as a marital community, thus became liable to "Corp A" for rent due.

Unbeknownst to the taxpayer, the "Does" filed incorporation papers with the Office of the Secretary of State on February 14, and proceeded to register with the Department as Corp A in April of that year. The Department has always recognized the corporate entity.

When Corp A took over the store and stock of goods, it took great pains to disassociate itself from the Corp B. It changed the name and signs, and now deals only in cash sales instead of having a charge business. Instead of transferring the liquor license, a new one was applied for. Fixtures in the store had been leased, so were released back to the lessor.

The store was closed from October 9 to October 14 for a thorough cleaning and to inventory the goods remaining on the shelves. Much of the merchandise was in very poor condition, and thus would be difficult to sell. Between the time the store reopened and the Department notified the taxpayer of possible successorship liability in the first part of November, goods (the great majority of which were perishables) worth about \$1,000 had been sold under summary foreclosure chapter 60.10 RCW. The remaining merchandise, worth about \$9,000, was placed in the warehouse pending sale by the sheriff under the formal foreclosure proceedings of chapter 61.12 RCW.

Corp A has, since the time of the hearing, submitted legal paperwork to the Department indicating that foreclosure of the taxpayer's landlord's lien has been completed.

DISCUSSION:

RCW 82.32.140 imposes liability for unpaid taxes upon successors:

When any taxpayer quits business, or sells out, exchanges, or otherwise disposes of his business or his stock of goods, any tax payable hereunder shall become immediately due and payable, and such taxpayer shall, within ten days thereafter, make a return and pay the tax due; and any person who becomes a successor shall become liable for the full amount of the tax and withhold from the purchase price a sum sufficient to pay any tax due from the taxpayer until such time as the taxpayer shall produce a receipt from the department of revenue showing payment in full of any tax due or a certificate that no tax is due and, if such tax is not paid by the taxpayer within ten days from the date of such sale, exchange, or disposal, the successor shall become liable for the payment of the full amount of tax, and the payment thereof by such successor shall, to the extent thereof, be deemed a payment upon the purchase price, and if such payment is greater in amount than the purchase price the amount of the difference shall become a debt due such successor from the taxpayer.

No successor shall be liable for any tax due from the person from whom he has acquired a business or stock of goods if he gives written notice to the department of revenue of such acquisition and no assessment is issued by the department of revenue within six months of receipt of such notice against the former operator of the business and a copy thereof mailed to such successor. (Emphasis added.)

RCW 82.04.180 defines what a successor is in these terms:

"Successor" means any person to whom a taxpayer quitting, selling out, exchanging, or disposing of a business sells or otherwise conveys directly or indirectly, in bulk and not in the ordinary course of the taxpayer's business, a major part of the materials, supplies, merchandise, inventory, fixtures, or equipment of the taxpayer. Any person obligated to fulfill the terms of a contract shall be deemed a successor to any contractor defaulting in the

performance of any contract as to which such person is a surety or guarantor.

WAC 458-20-216 (Rule 216) is the Department's duly adopted rule regarding successor liability. By virtue of RCW 82.32.300, it has the same force and effect as the law itself. In addition to the statutory definition of "successor," the rule also provides:

The word "successor" includes all persons who acquire the taxpayer's equipment or merchandise in bulk, whether they operate the business or not, unless the property is acquired through insolvency proceedings or regular legal proceedings to enforce a lien, security interest, judgment, or repossession under a security agreement. The following factual situations illustrate the application of the foregoing.

. . .

5. Taxpayer leaves business, including fixtures and stock of goods, which his landlord holds for unpaid rent. The landlord will be a successor unless he proceeds to foreclose his landlord's lien by posting notice and holding a sale by the sheriff.

a. If the landlord, instead of foreclosing his lien, takes a bill of sale to all of the taxpayer's interest in the business or stock of goods in satisfaction of rent, he is a successor.

b. If the landlord fails to foreclose his lien and sells the fixtures or stock of goods and the purchaser continues the business or a similar business, the purchaser is a successor.

c. If the taxpayer does not leave any fixtures or stock of goods and the landlord engages in a like business in the same location or rents to a third person, neither the landlord nor the third person is a successor. (Emphasis added.)

At the time the Department first contacted Corp A regarding possible successorship liability in early November, no formal judicial proceedings under chapter 61.12 RCW had occurred, and that corporation was found to be a successor. Corp A has testified, and court records indicate, that at that time \$1,000 worth of perishable goods had already been sold.

Corp A has first argued that there has never been a sale or conveyance from Corp B to itself, and that the statutes and

regulations relating to successorship liability address successor liability only in the context of a "sale or conveyance." We disagree. RCW 82.04.180 states that one may become a successor when another taxpayer ". . . conveys, directly or indirectly, . . ." RCW 82.32.140 speaks of when a taxpayer quits business, or "otherwise disposes of his business or his stock of goods. . . ." Rule 216 not only states that a "successor" includes "all persons who acquire the taxpayer's equipment or merchandise in bulk . . . ," but gives examples of property being gained by virtue of security interests and other liens.

[1] Thus, the acquisition of property subjecting a taxpayer to successorship liability does not have to be by virtue of a direct conveyance or sale by a predecessor.

Chapter 60.72 RCW, which provides a landlord's lien for rent, provides as follows:

Any person to whom rent may be due, his executors, administrators, or assigns, shall have a lien for such rent upon personal property which has been used or kept on the rented premises by the tenant, except property of third persons delivered to or left with the tenant for storage, repair, manufacture, or sale, or under conditional bills of sale duly filed, and such property as is exempt from execution by law. Such liens for rent shall be paramount to, and have preference over, all other liens except liens for taxes, general and special liens of labor, and liens of mortgages duly recorded prior to the tenancy. Such liens shall not be for more than two months' rent due or to become due, nor for any rent or any installment thereof which has been due for more than two months at the time of the commencement of an action to foreclose such liens; no writing or recording shall be necessary to create such lien; and if such property be removed from the rented premises and not returned to the owner, agent, executor, administrator, or assign, said lien shall continue and be a superior lien on the property so removed for ten days from the date of its removal, and said lien may be enforced against the property wherever found. . . .

RCW 60.72.040 provides, "[s]aid lien may be foreclosed as provided in Chapter 60.10 RCW and RCW 61.12.162." The first section is a summary self-help procedure which may be used within strict parameters; the second section provides for a more formal judicial procedure by which a sheriff's sale may be ordered.

Rule 216 implies that a sheriff's sale is an absolute prerequisite for foreclosure, in which a lien creditor must, of course, have first obtained a court order of foreclosure. The Department, however, has nonetheless always recognized that other summary self-help methods of foreclosure are provided for by law. It is not the intent of the rule to preclude the use of such procedures.

Chapter 60.10 RCW provides for the summary foreclosure of personal property liens. RCW 60.10.020 states:

Any lien upon personal property, excluded by RCW 62A.9-104 from the provisions of the Uniform Commercial Code (Title 62A RCW), may be foreclosed by an action in the superior court having jurisdiction in the county in which the property is situated in accordance with RCW 61.12.162, or it may be foreclosed by summary procedure as provided in this chapter. (Emphasis added.)

(Note: The enforcement of landlord liens is specifically excluded from the Uniform Commercial Code by RCW 62A.9-104(b).)

RCW 60.10.030, in pertinent part, further provides:

(1) A lien foreclosure authorized by RCW 60.10.020 may be summarily foreclosed by notice and sale as provided herein. The lien holder may sell, or otherwise dispose of the collateral in its then condition or following any commercially reasonable preparation or processing. . . .

. . . .

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable which shall be construed as provided in RCW 60.10.070. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the lien holder to the lien debtor, and except in the case of consumer goods to any other person who has a security

interest in the collateral and who has duly filed a financing statement indexed in the name of the lien debtor in this state or who is known by the lien holder to have a security interest in the collateral. The lien holder may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale. (Emphasis added.)

"Commercially reasonable" is construed by RCW 60.10.070:

As used in this chapter, "commercially reasonable" shall be construed in a manner consistent with the following:

The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the lien holder is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the lien holder either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. . . . (Emphasis added.)

[2] The \$1,000 worth of perishables and other products were of a type customarily sold in the retail marketplace and were in fact sold by Corp A (prior to learning that it might be considered a successor) in the normal operation of the convenience market which it had taken over and begun operating under a new name. Such sales were "commercially reasonable" under RCW 60.10.070, and under RCW 60.10.030(3), notice to the lien debtor was unnecessary. Thus, the property was properly "acquired through . . . regular legal proceedings to enforce a lien." Its subsequent sale in accordance with the summary foreclosure provisions of chapter 60.10 RCW did not subject the taxpayer to successorship liability, despite the fact that the taxpayer, by virtue of selling the goods, was operating a similar business in the same location. Corp A, having made changes to the store's name, licenses, and operating procedures, could not reasonably be confused with the prior business conducted at the same location.

The remaining property worth \$9,000 was sold on June 18, 1986 at a foreclosure sale conducted by the sheriff pursuant to court order in accordance with the provisions of chapter 61.10 RCW.

This portion of the foreclosure occurred after the Notice of Successorship Liability had been issued.

[3] Rule 216 does not address when actual foreclosure must occur. We see no reason, if it is indeed accomplished in accordance with the law, why a foreclosure action cannot occur after the Department has issued a Notice of Successorship Liability. Accordingly, we hold that because all property was legally foreclosed in this case, Corp A here is not a successor.

DECISION AND DISPOSITION:

The taxpayer's petition for Correction of Notice of Successorship Liability is granted. The Notice will be cancelled.

DATED this 25th day of November 1986.