

Cite as Det. No. 21-0033, 41 WTD 327 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 21-0033
)	
...)	Registration No. . . .
)	

WAC 458-20-216(5)(c); RCW 82.32.140: SUCCESSORSHIP LIABILITY – ASSUMPTION OF DEBTS AND CONVEYANCE OF ASSETS. A franchise restaurant owner is the successor to the previous owner of the same franchise in the same location when the franchise restaurant owner assumed the previous owner’s lease and the previous owner conveyed its tangible and intangible assets to the franchise restaurant owner.

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.

Peña, T.R.O. – A franchise restaurant owner protests the assessment of successorship liability for the taxes owed by an owner of the same franchise that immediately preceded it in the same location under the same lease. We deny Taxpayer’s petition.¹

ISSUE

Under RCW 82.32.140 and WAC 458-20-216, is a new franchise restaurant owner the successor to a predecessor franchise restaurant owner when the new franchise owner takes over the predecessor’s location, equipment, and lease?

FINDINGS OF FACT

. . . (Taxpayer) is the owner of a . . . franchised restaurant, which was operated under a franchise agreement with [Franchisor]. On . . . 2020, Taxpayer completed an online business license application with the Department with its first date of business listed as January 6, 2020.

The physical location was listed as:

...

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

For the application question, “Did you buy, lease, or acquire all or part of an existing business?” Taxpayer answered “all.” Under Prior Business Name, Taxpayer listed “. . . .”

. . . (Predecessor) was also the owner of a . . . franchised restaurant operated under a franchise agreement with [Franchisor] and located at the same address listed above Predecessor occupied the space under a lease from the building owner for which [Franchisor] was the guarantor. [In] 2019, the Department revoked Predecessor’s certificate of registration due to two unpaid tax warrants stemming from unpaid tax liabilities. Predecessor’s December 2019 excise tax return lists \$. . . of gross revenue and its January 2020 excise tax return, its final return, lists \$. . . of gross revenue. Both Predecessor and Taxpayer registered and used the tradename “. . . [Tradename].”

After Predecessor ceased to operate, Taxpayer assumed Predecessor’s lease, including the balance due on the lease of \$. . . Taxpayer provided a copy of an email exchange between Franchisor and the landlord in support.

On February 19, 2020, the Department’s Compliance Division (Compliance) issued a Notice and Assessment of Successorship Liability Letter ID: . . . against Taxpayer for Predecessor’s unpaid tax liabilities. Taxpayer timely petitioned for administrative review of the assessment. According to Compliance, the assessment was based on the following factors:

- Taxpayer filed a business license application on . . . 2020, acknowledging the complete acquisition of Predecessor.
- Predecessor informed the Department that Taxpayer acquired all of Predecessor’s tangible assets. Predecessor submitted an equipment list, which itemizes the assets Taxpayer obtained.
- Taxpayer uses the same company phone number as Predecessor.
- Taxpayer uses the same tradename as Predecessor.
- Taxpayer acquired Predecessor’s lease.

Predecessor provided Compliance with a list of tangible assets Predecessor claims to have left in the restaurant and transferred to Taxpayer, which includes . . . restaurant equipment. Taxpayer submitted a valuation conducted by [Franchisor] that estimates the total value of the tangible assets as \$. . . Taxpayer argues, however, that the tangible assets became the landlord’s property under the lease when Predecessor abandoned the leased property. Thus, according to Taxpayer, it acquired the tangible assets from the landlord and not Predecessor. Taxpayer’s lease does not contain any provision for the landlord to take possession of abandoned assets.

Taxpayer claims [Franchisor] had a purchase money security interest in the assets of Predecessor to secure the purchase price of certain pieces of equipment in the leased property. Taxpayer did not specify which pieces of equipment or provide any documentation but maintains [Franchisor] could repossess those pieces of equipment when Predecessor abandoned them and its lease without becoming a successor.

Taxpayer also provided a copy of its template “[. . .] Franchise Agreement” (Franchise Agreement) between [Franchisor] and a franchisee. Paragraph 6.2 provides all Trademarks belong to [Franchisor] and Trademarks is defined as “trade names, trademarks, services marks, logos, and

commercial symbols associated with [Franchisor] and licensed to Franchisee, whether or not registered.” Definitions, Franchise Agreement. The Franchise Agreement also specifies . . . [Franchisor] must approve all uses of its trademarks in writing. 6.3 Limitations of Use. Taxpayer argues under the Franchise Agreement, Predecessor had no rights to intangible assets to convey to Taxpayer.

Taxpayer also argues [Franchisor] had a pre-existing right to assume Predecessor’s telephone number granted by the “. . . Conditional Assignment of Telephone Numbers” between Predecessor and [Franchisor], dated . . . 2018 (Conditional Assignment). The Conditional Assignment provides that . . . [Franchisor] had the right to assume ownership of the telephone numbers used by Predecessor on the termination of the Franchise Agreement and that Predecessor grants this conditional assignment as partial consideration for, and a condition of, [Franchisor]’s grant of the franchise to Predecessor. Under the Conditional Assignment, [Franchisor] would assume all of Predecessor’s obligations to the telephone company. Taxpayer claims there was a balance due for past service from Predecessor for \$. . . The phone bill produced by Taxpayer, which covers service dates January 27, 2020, through February 26, 2020, shows an unpaid balance of \$. . . and new charges of \$. . . for the service period.

ANALYSIS

Whenever any taxpayer quits business or sells out, exchanges, or otherwise disposes of more than fifty percent of the fair market value of either its tangible or intangible assets, any tax payable under Chapter 82.32 RCW shall become immediately due and payable. RCW 82.32.140(1). RCW 82.32.140(2) contains the trigger for liability of a successor, stating:

Any person who becomes a successor shall 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. If any 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. If the fair market value of the assets acquired by a successor is less than fifty thousand dollars, the successor's liability for payment of the unpaid tax is limited to the fair market value of the assets acquired from the taxpayer. The burden of establishing the fair market value of the assets acquired is on the successor.

The effect of RCW 82.32.140 is to place the burden of any unpaid tax liability incurred by the predecessor on the successor, thereby making the successor secondarily liable for such tax. *Tri-Financial Corp. v. Dep’t of Revenue*, 6 Wn. App. 637, 640, 495 P.2d 690 (1972). The successor provisions enacted by the legislature are intended to ensure the collection of excise taxes remaining unpaid by a taxpayer who quits, sells out, exchanges, or otherwise disposes of his business or stock of goods. *Id.* at 642. RCW 82.32.140 also discourages delinquent taxpayers from avoiding tax by opening a new entity to keep essentially the same business going as a successor. Det. No. 14-0043, 33 WTD 394 (2014).

The definition of successorship is not read narrowly. Det. No. 85-215A, 1 WTD 13 (1986), *citing Tri-Financial Corp.*, 6 Wn. App. 637.

A “successor” is defined in RCW 82.04.180(1)(a) as:

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, more than fifty percent of the fair market value of either the (i) tangible assets or (ii) intangible assets of the taxpayer.

Thus, a taxpayer is a successor of a predecessor, if: 1) the predecessor quit, sold out, exchanged, or disposed of its business; 2) sold or otherwise conveyed, directly or indirectly; 3) in bulk and not in the ordinary course of its business; 4) more than fifty percent of the fair market value of either its tangible assets or intangible assets; 5) to the taxpayer. *Id.*; Det. No. 05-0313, 26 WTD 27 (2007).

Because there is no dispute that Predecessor ceased to operate, we first look to whether there was a conveyance. Here, the evidence before us indicates Predecessor conveyed, directly or indirectly, more than 50 percent its tangible and intangible assets to Taxpayer. By its own admission in its business license application, Taxpayer “bought, leased, or acquired” *all* of Predecessor’s business. Nevertheless, we discuss the individual assets below.

Tangible Assets

Regarding the tangible assets left in the restaurant, Taxpayer argues there was no conveyance because the lease provides that the tangible assets were conveyed first to the landlord and then from the landlord to Taxpayer. An acquisition of property does not have to be through a direct sale or conveyance for purposes of RCW 82.04.180. Det. No. 14-0153, 33 WTD 534 (2014). In 33 WTD 534, the taxpayer protested a successorship assessment after it assumed the debts of an insolvent company (the predecessor) in exchange for most of company’s assets. The taxpayer argued that it did not purchase the predecessor’s assets for cash and there was no purchase price. We concluded that the taxpayer was the successor of the predecessor because neither RCW 82.32.140 nor RCW 82.04.180 requires that the successor acquires the predecessor’s assets in a formal sale. In addition, RCW 82.32.140(2) does not rule out one being a successor if there is no purchase price.

Despite Taxpayer’s claim otherwise, Predecessor’s lease does not include any provision granting abandoned property to the landlord. Furthermore, Taxpayer’s claim that [Franchisor] had a security interest in some of the tangible assets remains unsupported. As in 33 WTD 534, Taxpayer assumed Predecessor’s debt [(the lease amount)] and took possession of Predecessor’s assets. Taxpayer assumed Predecessor’s obligation for the past due balance in exchange for taking over the lease and acquired Predecessor’s tangible assets and a number of Predecessor’s intangible assets.

Intangible assets

Trade Name

Compliance concluded Taxpayer acquired Predecessor's tradename, lease, and phone number. The tradename “. . . [Tradename],” however, never belonged to [Predecessor] and was not it's to convey. Per the Franchise Agreement, the name “. . . Tradename” belongs to . . . [Franchisor] as its trademark and a franchisee can only use it as permitted in the Franchise Agreement. Thus, both Predecessor and Taxpayer using the name “. . . [Tradename]” is not evidence of the exchange of the name from the former to the latter.

Lease

As we concluded above, Predecessor conveyed the lease to Taxpayer in exchange for an assumption of debt.

Phone Number

Here, it is undisputed Taxpayer has the same phone number used by Predecessor. Taxpayer, however, maintains it was [Franchisor], not Taxpayer, that acquired the phone number from Predecessor under the terms of the Conditional Assignment, as partial consideration for the original granting of the franchise to Predecessor. It follows that [Franchisor] then transferred the phone number to Taxpayer. We agree with Taxpayer that the Conditional Assignment appears to have both granted [Franchisor] the right to the phone number and made it responsible for the balance due to the phone company. We find Predecessor did not convey the phone number to Taxpayer.

Goodwill and Location

In addition to the intangible assets listed by Compliance, the goodwill and location have value. Such items must also be considered. Det. No. 05-0313, 26 WTD 27 (2007). We acknowledge much of the goodwill inherent to Predecessor was specific to the reputation of [Franchisor], which was also not directly conveyed by the Predecessor, but by purchase from [Franchisor]. However, whatever unique goodwill Predecessor itself possessed was likely transferred to Taxpayer as a new franchisee of the same franchise, operating in the same location, with the same phone number, and commencing business the month following the cessation of Predecessor's business.

Taxpayer attempts to distinguish its situation from that of 33 WTD 534, arguing in that case the taxpayer took title to the assets in exchange of the assumption of debt, which is not how it views what happened here. Moreover, it maintains there was no purchase agreement. However, neither RCW 82.32.140 nor RCW 82.04.180 require that the party acquire more than 50% of the predecessor's assets in a formal sale. A “successor” includes individuals that acquire the previous business by sale, exchange, or other direct or indirect conveyance. RCW 82.04.180(1)(a). RCW 82.32.140(1) and (2) also refer to the triggering event for successorship liability as a “sale, exchange, or disposal” of 50% or more of the tangible or intangible assets of the predecessor. The reference to “purchase price” in RCW 82.32.140(2) only states that any person who becomes a

successor shall withhold from the purchase price a sum sufficient to pay any tax due. RCW 82.32.140(2) does not rule out one being a successor if there is no purchase price, only that if there is a purchase price, the successor shall withhold the requisite amount of tax due. Here we have a purchase price of \$. . . , the debt Taxpayer assumed on the lease. Taxpayer cannot choose to be liable for only the lease debt in order to acquire those assets from Predecessor and still avoid the tax debt incurred by Predecessor.

As discussed above and by its own admission on its business license application, Predecessor conveyed to Taxpayer all of Predecessor's tangible assets and all intangible assets but Predecessor's phone number and trade name. Predecessor sold in bulk and not in the ordinary course of its business more than fifty percent of the fair market value of either its tangible assets or intangible assets to Taxpayer. Thus, Taxpayer is liable as a successor for Predecessor's unpaid tax liability. *See* RCW 82.04.180(1)(a).

In certain circumstances successors may limit the amount of their liability for a predecessor's taxes. If a taxpayer proves that the assets it acquired from its predecessor had a fair market value less than \$50,000 at the time of acquisition, the taxpayer's successorship liability for its predecessor's unpaid tax is limited to the fair market value of those assets. RCW 82.32.140(2); WAC 458-20-216(5)(c) (Rule 216). We note that for purposes of RCW 82.32.140(2) and Rule 216(5)(c), the taxpayer has the burden of establishing the fair market value of the assets it acquired from the predecessor.

For the intangible assets, Taxpayer produced no evidence of their fair market values. Regarding tangible assets, in Det. No. 16-0337, 37 WTD 015 (2018), we held an appraisal of the predecessor's tangible assets was insufficient to meet the taxpayer's burden of proving the fair market value of all assets it acquired from the predecessor under RCW 82.32.140(2) and Rule 216(5)(c) as it did ". . . not detail the valuation methodology used, or discuss comparable assets or other information used by Appraiser to value the assets." Here, Taxpayer produced a valuation conducted by [Franchisor] with no information on the valuation methodology. As in 37 WTD 015, this is insufficient to meet Taxpayer's burden of proving the fair market value of the tangible assets.

We conclude, therefore, that Taxpayer has not provided complete and reliable proof of the total value of both tangible and intangible property it acquired from Predecessor, as required by RCW 82.32.140(2) and Rule 216(5)(c). As Taxpayer has not met its burden of establishing the fair market value of the assets it acquired from Predecessor, Taxpayer is liable for Predecessor's tax pursuant to RCW 82.32.140(2). Taxpayer's petition is denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 17th day of February 2021.