Pending Sale of Company Uncovers Massive Liability

Selling the Family Business

A father and son owned and operated a very successful manufacturing business with sales all across the country. After 20-plus years of hard work, they decided it was time to sell and move on to other pursuits. Fortunately, relatively quickly they found a purchaser who, after some negotiation, was willing to meet their selling price in excess of $30 million for the company. (Please note that the specific sales figures have been changed to protect confidentiality.) Of course the deal was contingent on a thorough due diligence review by the purchaser. In the process of that review, the purchaser discovered potentially serious state income and sales tax issues that threatened to derail the entire sale. The potential liabilities arose because the seller had nexus in many states by virtue of independent sales reps throughout the country but had done no filing or tax collections in those states. The seller had no idea that sales reps gave them nexus, but the purchaser knew this was a potentially serious issue. Since the company had never been registered in other states, those other states, if they found this company would go back many years and collect the back taxes plus penalty, and interest. The purchaser now began to see this deal in a damaging new light — they could be buying a lemon. They decided they could not move forward on this purchase unless the seller was willing to set aside a substantial amount of the purchase price as a reserve against future potential liabilities. So they changed their offer to put approximately half of the agreed upon sales price in escrow.

This discovery of potential liabilities and request for the set aside shocked (and angered) the sellers. How could this be? Why did we not know about this earlier? Is this even possible — since when do we have to collect taxes just because of independent sales reps?

Time to Panic?

Discovering a previously unknown and unaccounted-for material liability is not something CPAs like to think about. The CPA representing the seller, who had been working with the seller's company for more than 20 years, was taken aback, to say the least, by this turn of events. Over those years, the CPA performed the full range of accounting services for this client including its annual financial audit. The CPA firm had always given the company a clean bill of health and never mentioned any potential sales tax exposure. No one expected any hiccups in the due diligence phase of the sale. Then came the revised offer with the shocking charges of potential deal-killing liabilities. Their client who had been so excited about closing on this deal, now looked to their long-time advisor for some answers.

Nexus Case Study

Thankfully, no one panicked.

The CPA firm knew to get us involved. They asked us first for our general impressions. Was the purchaser on solid ground here? Did the seller actually owe these taxes? How likely was it that the seller's company would even be audited since they'd never had a problem in 20 plus years? If the liabilities were justified, was there any way to reduce them?

Of course, we had our own questions. First, we confirmed, that, unfortunately for the seller and his CPA, we believed the purchaser was correct as to the nexus assertion. The utilization of independent sales reps is a well settled nexus-creating activity (See Nexus white paper).

The purchaser was also correct in asserting that because the company was never registered for sales and use tax, there was no statute of limitations and that in theory, tax, penalty and interest could be owed from the date the company began doing business in these states. As a practical matter, states routinely go back 7 to 10 years. But we did come up with a plan.

It Ends Well, With Some Luck

Even though the purchaser was correct in their assertions, the seller was not without any options. Our plan included a proposal to use a combination of voluntary disclosure agreements (VDA), the Streamlined Sales Tax Project (SSTP) amnesty program, individual state amnesty programs, and a customer contact program. The luck part of this plan was that there were a few states that offered a broad amnesty for the time periods involved. The other lucky part is that in two of the states there happened to be a specific exemption regarding property incorporated into land owned by the federal government that we could use.

The bottom line is that this plan resulted in a vastly reduced amount of tax owed, the elimination of all significant penalties, and an elimination of the potential interest in some states and a reduction in others. Our plan allowed for the reduction a $15 million liability to less than $2 million. Once the purchaser was convinced that the plan would work, they revised their offer to eliminate the requested set aside.

Deal saved. Client happy. CPA happy. That's all we could have hoped.

About Us

Peisner Johnson & Company is a CPA firm with a clear mission: Solve clients' state tax problems. Because we focus exclusively on state and local taxes, we have developed a deep understanding of state tax issues. Our staff includes former state tax auditors and tax professionals from across the country, and our clients benefit from our extensive knowledge and experience and our client-first mentality. We have consulted with thousands of companies doing business across the United States and Canada in virtually every industry.