
Coates' Canons Blog: Collecting Property Taxes from Corporations

By Guest Blogger

Article: <https://canons.sog.unc.edu/collecting-property-taxes-from-corporations/>

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[Today's guest blogger is Adam Parker, UNC School of Government summer law clerk.]

Let's begin with an all-too-familiar hypothetical. In 2006, Carl Corporation incorporated a small business, Tar Heel Roofing Inc. Business went well for a few years. But when the Great Recession hit, Carl's customers basically disappeared. After six months with no revenue Carl decided to get out of the roofing industry.

In July 2011, Tar Heel Roofing sold all of its assets—a truck, two roofing machines (kettle and roof cutter), and some supplies—to a friend who runs Wolfpack Roofing, Inc. Carl moved to a remote mountain cabin in West Virginia and stopped paying property taxes on a two-acre parcel of land in rural Carolina County, NC, that is listed in the name of Tar Heel Trucking, Inc., a corporation created by Carl back in 2002 when he tried (unsuccessfully) to start a trucking business.

Tar Heel Roofing and Tar Heel Trucking now owe two years of delinquent taxes on their respective property. What options does Carolina County Tax Collector Tina have to collect these taxes?

Corporations are separate legal entities from their shareholders, officers, and incorporators. G.S. § 55-6-22. Absent unusual circumstances only Tar Heel Roofing and Tar Heel Trucking will be liable for their respective tax obligations, meaning only assets owned by each corporation will may be targeted by Tax Collector Tina to satisfy that corporation's tax obligations. But the Machinery Act and general corporate law may give Tina some options to collect from either Carl or from Wolfpack Roofing, the corporation that purchased the assets of Tar Heel Roofing.

Foreclosure

The county of course may foreclose on the real property owned by Tar Heel Trucking. Even if this rural property has little market value, foreclosure may make sense if a buyer can be found who will resume paying taxes on the property. However, foreclosure will not be a remedy to collect the delinquent taxes on the business property owned by Tar Heel Roofing. Those taxes are not a lien on the real property owned by Tar Heel Trucking even though both corporations were created by and owned by the same individual (Carl) exclusively.

Targeting Corporate Property for Corporate Tax Obligations

When considering enforced collection actions against a corporation, the tax collection should first determine the status of that corporation. The key question: is it still a functioning entity or has it been dissolved?

If the corporation was formally dissolved through the filing of articles of dissolution with the Secretary of State, notice should have been given to all creditors including local governments who were owed taxes. G.S. § 55-14-06; 55-14-07. If either Tar Heel Roofing or Tar Heel Trucking were formally dissolved and no notice was given to Carolina County, then Tina could go after any assets disbursed to the shareholders (in this case, Carl, as he owned both corporations entirely).

Corporations are often not dissolved formally, in which case the tax collector's options are limited. In that situation, the tax collector would have to disregard the corporate form to hold Carl (the shareholder) liable for the corporation's debt. Two theories support this course of action: faulty incorporation and piercing the corporate veil.

Faulty Incorporation

If Carl incorporated either Tar Heel Roofing or Tar Heel Trucking incorrectly, he may be liable under what is commonly known as promoter liability. Tina should look at the organizing documents to determine whether each corporation was

incorporated correctly. The elements of a proper incorporation are laid forth in G.S. §§ 55D-10; 55-2-02; 55-2-03.

Generally, shareholders, directors and officers of a “pretended” corporation which is neither de jure (incorporated correctly) or de facto (lacking formal corporate status, but nonetheless operating as a corporation) may be held personally and individually liable for the debts of a “pretended” corporation. *Charles A. Torrence v. Clary*, 121 N.C. App. 211, 464 S.E.2d 502 (1995). If Carl can be shown to have made a good faith attempt to form the corporation, however, he will likely avoid liability for a faulty incorporation.

Piercing the Corporate Veil

If Carl avoids liability for faulty incorporation, Tina could pursue liability under a theory of piercing the corporate veil. Piercing the veil involves a court disregarding the general principle that shareholders are not liable for the corporation’s liabilities (G.S. § 55-6-22) to impose liability on the individual shareholders. North Carolina courts generally consider nine factors in determining whether to pierce the corporate veil and hold individual shareholders liable, including:

1. Inadequate capitalization
2. Failure to comply with corporate formalities
3. Complete domination and control of the corporation so that it has no independent entity
4. Excessive fragmentation of single enterprise into separate corporations
5. Non-payment of dividends
6. Insolvency
7. Siphoning of Funds by the Dominant shareholder
8. Non-functioning of other officers/directors
9. Absence of corporate records

Glenn v. Wagner, 313 N.C. 450, 329 S.E.2d 326 (1985). A shareholder can be held liable for corporation obligations if the corporation was operated as a *mere instrumentality* or *alter ego* of the shareholder. *East Market Square v. Tycorp Pizza*, 175 N.C.App 628, 625 S.E.2d 191 (2006). In other words, if the shareholder himself ignores the corporate entity when dealing with corporate assets, the courts will do so too.

In *Tycorp Pizza*, there were several corporations owned by a single owner, including Tycorp IV, which was to operate a Pizza Hut in Greensboro. The Court of Appeals held that due to the extent of control the owner exercised over Tycorp IV and the other Tycorp corporations (which also operated Pizza Huts), the commingling of the different corporations’ assets, and the undercapitalization of Tycorp IV (which was provided with inadequate funds to open the Pizza Hut), the parent corporation Tycorp and the CEO of the Tycorp corporations were liable for Tycorp IV’s debts.

If the legal theory in *Tycorp Pizza* were to apply to Carl and his two corporations, Tax Collector Tina could target Carl’s property to satisfy corporate tax obligations. She could also use the assets of Tar Heel Roofing to satisfy the tax obligations of Tar Heel Trucking, and vice-versa.

North Carolina courts have yet to pierce the corporate veil to hold shareholders liable for a corporation’s tax obligations. But plenty of other states’ courts have done so. For example, see *Comm’r of Envtl. Prot. v. State Five Indus. Park, Inc.*, 304 Conn. 128, 157–58, 37 A.3d 724, 742–43 (2012); *In re Lanier*, 383 B.R. 302, 307 (Bankr. E.D.N.C. 2008); *Oxford Capital Corp. v. United States*, 211 F.3d 280, 284 (5th Cir. 2000); *United States v. Scherping*, 187 F.3d 796, 802 (8th Cir. 1999). And one North Carolina court has pierced the corporate veil to hold shareholders liable for financial obligations owed to the state that were similar to taxes. *State ex rel Cooper v. Ridgeway Brands Mfg., LLC*, 362 N.C. 431, 666 S.E.2d 107 (2008) (holding shareholders liable for escrow payments owed to state by corporate manufacturer of cigarettes under the national tobacco settlement).

If Tina thinks Carl could be held liable by piercing the corporate veil, she should consult with the county attorney before proceeding further. If the attorney agrees that Carl is simply an alter ego of either Tar Heel Roofing or Tar Heel Trucking, the county could proceed with Machinery Act attachment and garnishment remedies against Carl. If Carl objects, the county can ask a state superior court to approve of the collection effort. The losing party will be responsible for the winning party’s court costs and attorneys fees. G.S. § 105-368(g). Given the general principle that corporations, not shareholders, are liable for their tax responsibilities, Tina should be careful in assessing whether Carl is liable and balance the risk of returning the seized assets *and* paying Carl’s attorneys fees (as well as its own) against the potential receipts from Carl’s

assets.

Successor Liability Under General Corporate Law

Another possibility is to attempt to hold Wolfpack Roofing liable for Tar Heel Roofing's unpaid property taxes under a theory of successor liability. As a general rule, a buyer who purchases only the assets of another corporation is not liable for the selling corporation's debts or liability. If Wolfpack Roofing had purchased the corporation, Tar Heel Trucking, rather than just that corporation's assets, then Wolfpack Roofing would have purchased Tar Heel Trucking's liabilities as well. But in this situation Wolfpack only purchased the truck, supplies and equipment, meaning Wolfpack is likely not stuck with successor liability for Tar Heel Roofing's tax obligations under general corporate law.

Successor Liability Under the Machinery Act

Generally the buyer of personal property does not assume personal liability for old taxes on that personal property because only the listing owner is personally responsible for taxes personal property. G.S. § 105-365.1(b)(2). However, G.S. § 105-366(d) does create successor liability for personal property taxes after "going-out-of-business" sales. This provision covers the sale of "goods, materials, supplies, or fixtures other than in the ordinary course of business." If taxes owed on the property being sold are not paid at closing, the tax collector may hold the buyer responsible.

The sale of Tar Heel Roofing's roofing supplies to Wolfpack Roofing likely triggers this provision. If Wolfpack fails to pay the taxes owed on those supplies, the county can hold Wolfpack liable for those taxes. Tina may use Machinery Act remedies (attachment and garnishment or levy and sale) against *any* personal property owned by Wolfpack so long as she begins the collection action within six months of the sale. After six months, Tina's only option is to sue Wolfpack in state court.

Tina probably cannot use G.S. § 105-366(d) to recover the taxes on the truck and the roofing machinery sold to Wolfpack because that property does not constitute "goods, materials, supplies or fixtures." Only Tar Heel Roofing remains personally responsible for those taxes.

Service of Process

Who should get notice of a foreclosure, attachment, or lawsuit against a corporation? The best approach is serve notice on the individual(s) listed with the North Carolina Secretary of State as the "registered agent" for the corporation. If the agent is out of state then service may be made to the North Carolina Secretary of State.

Assuming Carl—who now resides in West Virginia—is the registered agent for both Tar Heel Roofing and Tar Heel Trucking, service on the North Carolina Secretary of State would be proper for actions against either of those corporations. Service on Wolfpack would be proper at the registered address of the agent here in North Carolina, assuming Wolfpack is an in-state corporation.

Adam Parker earned his MPA from the UNC School of Government in 2010 and is currently a rising third-year student at the UNC School of Law. This article was researched and written under the supervision of faculty member Chris McLaughlin. Any questions about the topics discussed above should be directed to McLaughlin at mclaughlin@sog.unc.edu.

Links

- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_55/GS_55-6-22.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_55/GS_55-14-06.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_55/GS_55-14-07.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_55D/GS_55D-10.html
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