Port-a-Potties Mired in Former Owners' Problems

by Robert W. Wood • San Francisco

Okay, so its not the most sophisticated sounding tax dispute. It even has a mirthful quality. The U.S. District Court for the Eastern District of Michigan has just ruled in a not insubstantial back-tax dispute that the government is entitled to levy against the assets of a new portable toilet business because the company is the alter ego or nominee of the old portable toilet business. This is hardly levying porta-potties to construction sites, or even carrying coal to Newcastle. It's just about tax dollars in whatever unlikely spots they can be found.

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PORT-A-POTTIES

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In *Porta-John of America, Inc. v. U.S.*, E.D. Mich., No. 96-70349 (April 6, 1998), the owners had been in that auspicious endeavor since the 1970s. The business failed twice, so they continued operations in different corporate structures (in different potties as it were). No matter what the corporate name or structure, Mr. and Mrs. Braxton and some regular employees (and even financing sources) remained consistent. At its peak, one franchisor company, Porta-John Corp., owned 14,000 portable toilets.

Various doctors came along to invest in enzyme processes and ultimately ended up as shareholders in a public company called Enzymes of America (perhaps seen as the future of the portable toilet industry). Enzymes was to go public, but ultimately did not, and Porta-John Corp. filed for bankruptcy. At that time, the bankruptcy petition disclosed that Porta-John had $56,985 in assets, and a whopping $4.2 million in liabilities. The Internal Revenue Service had garnished over $94,000 in the prior year. Porta-John also owed $18,322 to the IRS, and over $480,000 to other taxing authorities.

Where's the Loo?

Despite Porta-John's ostensible business, not one single portable toilet was listed as an asset of the bankruptcy estate. When the bankruptcy petition was filed, the company had no assets because Mr. and Mrs. Braxton had already transferred the assets to another company, America West Service Corp. America West took over the functions of Porta-John as well as the assets, and became a franchisor of, guess what...portable toilets.

Various pollution and regulatory problems follow here in the story, but the matter quickly devolved into hundreds of thousands of dollars of unpaid employment taxes, penalties and interest. The matter got even more tawdry when in May 1992, America West had its contract with Camp Pendleton (which needs lots of portable toilets, after all) was terminated. Plus, America West was barred from that military facility for illegally dumping waste on the base.

Faced with a repossession of all of its assets, Mr. and Mrs. Braxton transferred assets once again, this time to Porta-John of America, Inc. Nine hundred portable toilets were transferred, as well as leasehold interests in another 1,241 toilets.

Enough's Enough

At this time, the federal government levied against the assets of Porta-John, claiming that it was an alter-ego or nominee of America West. The District Court faced the alter-ego argument relatively easily, concluding that Porta-John was the alter-ego or nominee of America West, and that the government could collect tax liabilities from one entity even though they were nominally assessed against the other. The government met its burden of proof by showing substantial evidence of the nexus between America West and the levied property.

Actually, the government disproved the plaintiff's claim for wrongful levy by establishing that Porta-John was the alter-ego or nominee of the other entity. The assets were obtained for less than adequate consideration, neither America West nor Porta-John providing any documentary evidence of payment on the toilet or truck leases, or the basis for America West's accrued debt, despite several specific requests on this point from the court on this point.

Potty Training

There are a number of more odiferous facts in *Porta-John of America, Inc.*, but one hardly has to read the fine print in this case (written on the bathroom wall or elsewhere) to discern a rather obvious point. In my experience it is rare to see indemnity clauses called into action to pay tax liabilities. Yet cases do arise that underscore the importance of being careful. Surely a company like Porta-John and its owners would not be involved in a high level acquisition in which their documents (or lack of documents) would be scrutinized.

Still, *M&A Tax Report* readers should remember that just last month we covered the illustrious case of successor tax liabilities in *U.S. v. First Dakota National Bank*, No. 97-1404 (8th Cir., March 6, 1998). Some readers may need the useful reminder that successor liability can and does exist. See Wood, "Successor Liability in Bank Acquisition," *M&A Tax Report*, Vol. 6, No. 10 (May 1998), p. 1. ■