

Full Length Research Paper

Bulk asset purchase transactions involving New York sales tax vendors: Be careful there and everywhere

James B. Biagi

School of Business and Global Innovation, Marywood University, Scranton, PA, USA.

Received 1 September, 2016; Accepted 18 October, 2016

This paper explores the potentially harsh impact of the bulk sales provisions of New York State's Tax Law on the purchaser of assets (either personal, intangible or real) from a sales tax vendor other than in the ordinary course of business. The author also points out that New York is not alone in its treatment of these types of transactions.

Key words: Bulk sales, sales tax, sales tax vendor, personal liability.

INTRODUCTION

Many of us have had an occasion to witness a situation in which a practitioner learns of a legal provision that adversely affects the outcome of a completed matter only after its closing. Experience has shown that one area in which this situation recurs involves the application of New York State Tax Law ("TL") §1141(c). In its simplest form, TL §1141(c) imposes personal liability on the purchaser of the business assets of a New York State sales tax vendor (whether properly or improperly registered) for part or all of the vendor's sales tax liabilities if the purchaser obtained those assets other than in the ordinary course of the vendor's business¹. As an exception to this rule, the purchaser will not be held liability if he strictly follows the pre-transfer notification provisions established under that statute in order to put the New York State (the "State") on notice of the transaction. Therefore, those practitioners involved in transactions for the purchase of business assets (that is, real estate closings, business sales, mergers and acquisitions and succession planning to name a few)

must consider TL §1141(c) or bear the consequent liability of failing to do so. (Fisher and Roberts, 2007)

METHODOLOGY

This paper outlines the elements of TL §1141(c) and sets forth a review of the pertinent New York State statutes, regulations and publications addressing the bulk sales provisions of the New York State's Tax Law, while pointing out that many other states follow similar provisions as it relates to the disposition of assets by a sales tax vendor. It must be noted that this paper is limited to an analysis of New York rules and that the exact provisions of all applicable state laws must be reviewed when involved in this type of business transactions.

RESULTS AND DISCUSSION

Discussion of the elements of TL §1141(c)

Generally, a purchaser of the assets of another business

Email: Biagi@marywood.edu.

Authors agree that this article remain permanently open access under the terms of the [Creative Commons Attribution License 4.0 International License](https://creativecommons.org/licenses/by/4.0/)

¹ It should be noted that these provisions apply not only to the purchase of assets but to their transfer, assignment and/or gift, as well.

does not expect to acquire the seller's debts, too. This is one of the primary benefits of an asset purchase as opposed to a typical corporate stock sale. New York has established laws designed to impose vicarious liability on the purchaser of the assets of another business if that business is obligated to collect and remit sales taxes. These provisions are imposed to protect the collection of unpaid sales taxes when assets that can be used to pay the taxes are transferred away. These legal provisions can be found in TL §1141(c) and the associated regulations located in Part 537 of Title 20 New York Code of Rules and Regulations ("NYCRR"). TL §1141(c) provides the following, in pertinent part:

"Whenever a person required to collect tax shall make a sale...in bulk of any part or the whole of his business assets, otherwise than in the ordinary course of business, the purchaser... shall at least ten days before taking possession of the subject of said sale...or paying therefor, notify the tax commission by registered mail of the proposed sale and of the price, terms and conditions."

TL §1141(c) further provides that:

"Whenever the purchaser... shall fail to give notice to the tax commission as required by the preceding paragraph, or whenever the tax commission shall inform the purchaser... that a possible claim for such tax or taxes exists, any sums of money, property or choses in action, or other consideration, which the purchaser... is required to transfer over to the seller... shall be subject to a first priority right and lien for any such taxes therefore or thereafter determined to be due from the seller to the state, and the purchaser is forbidden to transfer to the seller any such sums of money, property or choses in action to the extent of the amount of the state's claim".

Moreover, TL §1141(c) provides that:

"For failure to comply with the provisions of this subdivision the purchaser shall be personally liable for the payment to the state of any such taxes therefore or thereafter determined to be due to the state from the seller except that the liability of the purchaser shall be limited to an amount not in excess of the purchase price or fair market value of the business assets sold to such purchaser whichever is higher".

Therefore, New York requires that when a purchaser buys a sales tax vendor's assets other than in the ordinary course of business, he must notify the New York Department of Taxation and Finance (the "Department") before closing and follow the additional provisions of TL §1141(c) or face the threat of a derivative liability for the amount of sales tax vendor's sales tax debt. Effectively, TL §1141(c) creates an inchoate lien in the purchase proceeds in favor of the State and holds the purchaser liable for the portion of the price distributed to seller in contravention of that lien. As such, it is critical that a purchaser affected by the provisions of TL §1141(c)

understand the mechanics employed by the State in its application and the process that the notification begins within the Department because failure to properly follow the provisions could become costly. It must be noted that many states have similar provisions in their sales tax laws and therefore, this problem is not unique to New York. This article focuses on New York's rule, but the effect of each state's rule on the issue must always be considered² (Carpenter, 2008).

When does TL §1141(c) apply?

With the understanding that not all practitioners have exposure to New York State Sales Tax issues, it may be appropriate to provide a basic discussion on the liability for this tax. New York, like many other states, imposes a tax based upon the retail sales price of tangible personal property and certain specific services, said tax being referred to as sales tax. The reader's attention is directed to TL §1105(a) and the Department of Taxation and Finance Publication 750 (6/10), "A Guide to Sales Tax in New York State" for a discussion of New York State sales tax. Although the customer is liable for the sales tax (TL §1133), TL §1132 places the responsibility for the collection and payment of this tax on the seller of the taxable items, commonly referred to as the vendor. As such, the vendor must collect the tax due from the consumer and remit it to the Department. In this manner, the vendor becomes liable in its own right for the tax and any such unpaid debt is a claim against the vendor's assets. An obvious question is then presented as to the consequences of a vendor's disposal of these assets in a bulk sale without paying the sales tax liability that has arisen from its business activities. TL §1141(c) was put in place to address this issue.

What is a bulk sale?

The sale, transfer or assignment of any asset used by a sales tax vendor in its business (referred to by the Department as Business Assets) can constitute a bulk sale and invoke the provisions of TL §1141(c) unless an exception applies. According to a series of examples set forth in the Department's regulations, Business Assets can include tangible personal property (such as store fixtures, trucks, inventory, machines and equipment), real estate (such as building, land or a lease interest) or intangibles provided the asset is used in the vendor's business³. Common business intangibles include copyrights, patents, trademarks and goodwill. According to Example 11 of the regulations, even the sale of accounts receivable at an amount other than a going rate

²By way of example and without intending to be all inclusive, Washington, Connecticut, Wisconsin, Georgia, Michigan, Missouri and Florida are among the states that follow similar rules to New York with regard to this issue according to the referenced Carpenter article. Fisher and Roberts point out that the District of Columbia, Maryland and Virginia also impose similar provisions.

³See 20 NYCRR §537.1(a).

discount could constitute a bulk sale. An outright sale of a business asset is not needed to trigger TL §1141(c). According to Examples 4 and 7 of the regulations, the gift of a Business Asset by its unincorporated owner could constitute a bulk sale. According to Example 2 of the regulations, the transfer of Business Assets in incorporation or re-organization could also constitute a bulk sale⁴ (*Acres Storage Company v. Commissioner*, 1986).

The most common exception to the bulk sale rule under TL §1141(c) involves Business Assets disposed of in the ordinary course of the vendor's business activities. The Regulations at §537.1(d) (1) define the phrase "ordinary course" to mean any function, operation or transaction that is customary to the course of business. The most common example of this ordinary course exception includes goods sold as part of retail sales⁵. The Regulations §537.1(d) also note that the sale of obsolete machinery or inventory, the use of equipment as trade-in or the normal factoring of receivables are ordinary course of business activities. The Regulations at §537.1(a) (4) further provide that a bulk sale does not include the sale, transfer or assignment of Business Assets in settlement of a valid lien, mortgage or security instrument or made by an executor, administrator, receiver trustee in bankruptcy or referee. Also, the sale by a business owner of personal assets does not constitute a bulk sale⁶ (*Higgins and McLaughlin v. Commissioner*, 1985).

Procedures and importance of notification

Therefore, whenever a sales tax vendor sells or disposes of Business Assets in bulk and other than in the ordinary course of its business, the person acquiring title to those assets shall be held liable for the vendor's unpaid sales tax up to the greater of the selling price or fair market value of the assets transferred unless the parties properly comply with the notification provisions set forth in TL§1141(c). These provisions mandate that the purchaser provide the Department a pre-closing notification and follow its instruction on whether or not to escrow funds from the closing proceeds to cover potential sales tax liabilities due from the seller. If the notification provisions are not followed or the purchaser neglects to escrow the funds requested by the Department, liability will be imposed upon the purchaser. In order to be relieved of this liability and comply with TL§1141(c), the party acquiring the assets must, among other things, notify the Department at least ten (10) days before taking possession of or paying for the assets. The notification must be submitted to the Department by registered mail on a properly completed Form AU-196.10, Notification of Sale, Transfer or Assignment in Bulk ("NSTA Form"). Within five (5) business days of receiving the NSTA Form, the Department must determine whether or not the seller

⁴See *Acres Storage Company, Inc. v. New York State Tax Commissioner* (3 Dept. 1986) 120 A.D.2d 854, 501 N.Y.S.2d 966. Liability for sales tax

may be liable for any unpaid sales taxes or whether it believes that an audit of the seller's records is necessary⁷.

Within that same five (5) day period, the Department must notify the purchaser accordingly. If the Department determines that the seller has no unpaid sales taxes or that an audit is not warranted, it will issue the purchaser a Form AU-197.1 stating that the purchaser may pay the full purchase price to the seller and will not be held liable for any unpaid taxes. Alternatively, the Department may issue a Form AU-196.2 indicating that the purchaser is not to pay the seller the purchase price until the Department completes a further review. Therefore, in order to close the transactions, the purchaser must escrow the proceeds as directed by the Department. If the Department directs that funds be held in escrow, it has 90 days from receipt of the notification to require that the purchaser use these escrowed funds to satisfy the seller's sales tax liability prior to disbursing any remaining proceeds of the sale.

Conclusion

TL §1141(c) establishes certain pre-closing notification requirements in the event of the bulk sale of assets owned by a business required to collect and remit New York State sales tax. More importantly, it also imposes harsh liability provisions on the party acquiring those assets by making it vicariously liable for the seller's unpaid sales taxes if these notification requirements are not followed. Many practitioners are unaware of these pre-closing provisions and only learn of them after a closing when the Department is attempting to collect seller's sales tax debts. It is the author's hope in writing this article that both practitioners and students will be made aware of TL §1141(c), plan accordingly and thereby, avoid this unnecessary liability. Because TL §1141(c) is applicable to (among other things) real estate closings, business sales, mergers and acquisitions and succession planning activities in New York, its effect must be considered by clients and practitioners alike when dealing in that jurisdiction. Moreover, because many states follow similar bulk sale rules, the issue of pre-closing notification of tax departments often arises in transactions outside New York.

Finally it must be pointed out that New York's reach in the imposition and collection of sales tax has grown far

transferred upon incorporation of business.

⁵See Tax Bulletin TB-ST-70 (June 24, 2013)

⁶See *Higgins & McLaughlin Inc. v. New York State Tax Com'n* (3 Dept. 1985) 109 A.D.2d 1029, 487 N.Y.S.2d 144. Business asset included a building that housed a bar and grill and private apartment. Bulk sale only applied to portion used as bar and grill.

⁷According to 20 NYCRR §537.2(c)(6) for purposes of the Department's five (5) day response period, the date of receipt of the AU-196.10 will be the date the form was actually delivered to the unit responsible to process it, but no earlier than ten (10) days before the later of the scheduled or actual closing date.

beyond its borders. New York has been in the forefront of the movement by states to impose the obligation on internet vendors (without physical locations in a state) to collect sales taxes from their in-state customers. By employing a strategy typically referred to as "affiliate nexus" or "click-through" nexus, New York has specifically targeted remote internet sellers with associates in-state and imposed upon them the obligation of a New York State sales tax vendor. (Varyani, 2014) In the past, these internet sales often escaped taxation, but now, many internet retailers from states other than New York may have unrealized New York State sales tax liabilities as a result of recent changes to the law. As such, issues related to TL §1141(c) may be more widespread than ever. Based on the foregoing, it is clear that the Bulk Sales provisions of the New York Tax Law, or any other state in which the seller does business, must be considered before the closing of any business transaction.

Conflict of interests

The author has not declared any conflict of interest.

REFERENCES

- Acres Storage Company, Inc. Vs. New York State Tax Commissioner (1986). 120 A.D.2d 854, 501 N.Y.S.2d 966
- Carpenter .Sr. RP (2008). Avoiding Successor Tax Liability of Business Assets. *Bus. Law Today* 18(2):1-2. <http://apps.americanbar.org/buslaw/blt/2008-11-12/carpenter.shtml>.
- Fisher MP, Roberts RM (2007). Bulk Sales: Provide Notice or Pay the Price. *Pillsbury on Real Estate*, Spring. <http://www.pillsburylaw.com/siteFiles/Publications/8BA9F1E10D1A7379EC65BBF5B20AF97F.pdf>
- Higgins & McLaughlin Inc. Vs. New York State Tax Commissioner (1985). 109 A.D.2d 1029, 487 N.Y.S.2d 144.
- New York State Code of Rules and Regulation, Part 537 of Title 20.
- New York State Department of Taxation and Finance Publication 750 (6/10). A Guide to Sales Tax in New York State. <http://www.tax.ny.gov/pdf/publications/sales/pub750.pdf>. Tax Bulletin TB-ST-70 (2013). New York State Department of Taxation and Finance Tax Bulletin TB-ST-70 (June 24, 2013).
- New York State Tax Law §§ 1105, 1132, 1133 and 1141.
- Varyani N (2014). Taxing Electronic Commerce: The Efforts of Sales and Use Tax to Evolve with Technology. 39 *Okla. City U.L. Rev.* 151.