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Buyer Beware: New Jersey Tax Court Strictly Enforces State's Bulk Sale Notice Requirements

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In *GABGEO, Inc. v. Director*, the New Jersey Tax Court recently addressed the State's sales and use tax bulk sale notice requirements in rendering its decision against the taxpayer.¹ The Court's decision highlights the importance for purchasers to strictly comply with bulk sale notice requirement or face potentially significant tax costs.

Facts

GABGEO, Inc. ("GABGEO"), the purchaser in this case, was formed in 1997 for the purpose of operating a hotel and restaurant. Less than a month after its formation, GABGEO purchased the physical assets and liquor license of a restaurant from the troubled P. Phaneromeni, Corp. ("Phaneromeni"). Along with Phaneromeni's assets and liquor license came a messy and costly tax problem.

Nine months prior to the closing of GABGEO's purchase of Phaneromeni, the New Jersey Division of Taxation (the "Division") notified Phaneromeni that it had obtained a judgment against the corporation for sales and use taxes and corporation business tax covering a five-year period. The Company was notified that it had to either pay the tax, begin an approved payment plan, or declare bankruptcy.

Not surprisingly, the Division's letter prompted a series of correspondence with the company's attorney, including extension requests based on the possibility of refinancing the business, which requests were granted by the Division. Finally, by letter dated July 7, 1997, approximately ten days prior to the closing date of Phaneromeni's sale transaction with GABGEO, Phaneromeni's attorney notified the Director that Phaneromeni had contracted with a "bona fide buyer" to sell the business, assets, liquor license and real property. This letter did not mention the identity of the prospective buyer, a sale price, firm closing date, or whether the purchaser would assume liability for any taxes owed by the seller. It was this letter that GABGEO, the purchaser, would later rely upon as satisfying the bulk sale notice requirements.

Approximately 60 days after the sale of Phaneromeni's business to GABGEO, the same attorney, now representing GABGEO, delivered a *Notification of Sales, Transfer or*

¹ *GABGEO, Inc. v. Director, Division of Taxation*, Nos. 007640-2004 & 007676-2004, 2006 N.J. Tax LEXIS 4, at *34 (N.J. Tax Ct. Apr. 21, 2006).

Assignment in Bulk (the “Bulk Sale Notice”) to the Division. The Division responded with a conditional tax clearance certificate letter enabling Phaneromeni to transfer its liquor license to GABGEO and a *Notice and Demand for Payment From Transferee to GABGEO* informing the company that it should pay \$34,969.54 still owed by Phaneromeni.² In subsequent correspondence, the Division notified GABGEO that it had not timely filed its Bulk Sale Notice.

In 1999, the Division completed another audit of Phaneromeni and determined that the company owed an additional \$417,187.90 in sales tax and interest for pre-sale tax periods. Faced with the prospect of paying more tax, GABGEO contended that it had complied with the Bulk Sale Notice procedures and, therefore, should not be assessed tax after the sale of Phaneromeni was consummated.³

Analysis

New Jersey law provides that “[w]henver a person required to collect tax shall make a sale, transfer, or assignment in bulk of any part or the whole of his business assets, otherwise than in the ordinary course of business, the purchaser, transferee or assignee shall *at least 10 days before taking possession of the subject of said sale*, transfer or assignment, or paying therefore, notify the director by registered mail of the proposed sale and of the price, terms and conditions thereof” (hereafter, the “Bulk Sale Notice statute”).⁴ For “failure to comply with the provisions of [the Bulk Sale statute] the purchaser, transferee or assignee . . . shall be personally liable for the payment to the State of any such taxes theretofore or thereafter determined to be due to the State from the seller, transferor or assignor, and such liability may be assessed and enforced in the same manner as the liability for tax under this act.”⁵

Relying upon the pre-sale letter sent by Phaneromeni’s attorney notifying the Director that the company had contracted with “a bona fide buyer,” GABGEO asserted that “they provided proper notice to the Director that the transaction was to take place,” and that such notice of the proposed sale was substantial compliance with the statute.⁶ The Division countered that a Bulk Sale Notice was not filed until September 11, 1997—nearly two months after the sale was completed.

The Tax Court began its analysis by noting that the pre-sale letter of July 7, 1997 on which GABGEO relies for compliance with the statute was sent by the attorney for *the seller*.⁷ However, “the obligation is on the *purchaser* to notify the Director of the proposed sale.”⁸ Thus, GABGEO, which was not represented by the attorney at the time, did not provide the Division with notice before the sale as it claimed.

² A substantial portion of the taxes owed by Phaneromeni was remitted to the Division following the sale with an understanding that GABGEO would pay the remaining amount owed.

³ The taxpayer also raised an estoppel argument, which the Court rejected.

⁴ N.J. STAT. ANN. § 54:32B-22(c) (emphasis added).

⁵ *Id.*

⁶ GABGEO, 2006 N.J. Tax LEXIS 4, at *19.

⁷ *Id.* (emphasis added).

⁸ *Id.*

Furthermore, the letter of July 7, 1997 “did not inform the Director that Phaneromeni had informed GABGEO of any owed taxes, nor did the letter inform the Director that GABGEO would assume liability of any owed taxes.”⁹ The Court held that in order to obtain transferee immunity from sales tax liabilities of the transferor, providing proper notice to the Director is vital. “While Phaneromeni and GABGEO may have had discussions on the issue of tax liability, it is important that the Director be formally notified in writing, so that the Director has adequate time to take the necessary steps to investigate the tax status of the seller and inform the purchaser of the amount of money to be escrowed in order to insulate itself from transferee liability.”¹⁰ As a result, the Court concluded that GABGEO did not comply with the Bulk Sale Notice statute.

The Court then addressed whether GABGEO *substantially* complied with the Bulk Sale Notice statute. Under New Jersey law, courts may “invoke the doctrine of substantial compliance to avoid technical defects of valid claims.”¹¹ To prove substantial compliance with a statute, a non-complying party must show (1) a lack of prejudice to the defending party; (2) a series of steps taken to comply with the statute involved; (3) a general compliance with the purpose of the statute; (4) a reasonable notice of petitioner’s claim; and (5) a reasonable explanation of why there was not a strict compliance with the statute.

Based on a review of each of these requirements, the Court concluded that GABGEO failed to prove it substantially complied with the Bulk Sale Notice statute. First, the Division was prejudiced by the failure of GABGEO to send notice of the sale until *after* the sale, since the failure precluded the Division from prescribing the withholding of money in an escrow account. Second, the failure to provide notice precluded the Division from performing an audit of the additional periods, which, when completed, ultimately revealed more liabilities. Finally, GABGEO acted with too little care in providing correspondence on its own behalf to the Division, which effectively frustrated the Division’s ability to tell GABGEO how much of the purchase price to place in escrow.■

⁹ *Id.* at *20.

¹⁰ *Id.* at *20-*21.

¹¹ *Id.* at *21-*22.



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