

STATE OF NEW YORK  
DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
**HERMIE'S MUSIC STORE, INC.** : DETERMINATION  
for Revision of a Determination or for Refund : DTA NO. 813242  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period June 1, 1993 :  
through August 31, 1993. :  
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Petitioner, Hermie's Music Store, Inc., 727 State Street, Schenectady, New York 12305, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1993 through August 31, 1993.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on July 18, 1995 at 9:30 A.M., with all briefs to be submitted by November 20, 1995, which date began the six-month period for the issuance of this determination. Petitioner appeared by Daniel C. Ertel, CPA. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Brian J. McCann, Esq., of counsel).

***ISSUES***

I. Whether the Division of Taxation properly determined that the transaction at issue herein constituted a sale, transfer or assignment in bulk pursuant to Tax Law § 1141(c).

II. If so, whether petitioner, as a bulk sale purchaser, is liable for taxes due from the bulk sale seller, DeSantis Music Schoolhouse, Inc.

III. If so, whether petitioner is entitled to credits for payments made to the bulk sale seller which the seller thereupon made to the Division of Taxation to reduce its sales tax liabilities.

***FINDINGS OF FACT***

1. At all times relevant hereto, Norman Frederick<sup>1</sup> was a 50 percent owner and was the manager of petitioner, Hermie's Music Store, Inc. ("Hermie's"), of Schenectady, New York. For approximately 20 years, Mr. Frederick had known Mario DeSantis, president of DeSantis Music Schoolhouse East, Inc. d/b/a Bonne Music of Syracuse, New York. Both Hermie's and Bonne Music were principally engaged in the business of selling musical instruments.

2. In June 1993, Mr. Frederick and Mr. DeSantis met after which Mr. DeSantis prepared a handwritten proposal setting forth terms under which Hermie's would purchase the inventory, accounts receivable and fixtures and equipment from Bonne Music (see, Petitioner's Exhibit "1"). Mr. DeSantis' proposal also included an employment contract whereby Mr. DeSantis would be employed by Hermie's for a period of five years at a salary to be negotiated.

3. By an agreement dated July 8, 1993 among DeSantis Music Schoolhouse East, Inc. d/b/a Bonne Music, as seller, Hermie's, as buyer, and Norman Frederick, as principal,<sup>2</sup> Bonne Music agreed to sell inventory, store fixtures, accounts receivable and the right to use the name "Bonne Music" for the purchase price of \$10,000.00, \$6,000.00 of which was to be paid on or before closing and the balance to be secured by a promissory note in a form as set forth in Schedule C of the agreement. Schedule C also contained an assignment provision, dated July 8, 1993, whereby Bonne Music assigned all of its right, title and interest in the promissory note to the New York State Department of Taxation and Finance. Pursuant to Schedule A of the agreement, inventory was valued at \$6,000.00, store fixtures at \$1,000.00, accounts receivable at \$2,000.00 and the right to use the "Bonne Music" name at \$1,000.00.

Schedule G of the contract contained an employment agreement whereby Hermie's agreed to employ Mario DeSantis for a term of five years as store manager and sales person for Bonne Music at a base salary plus bonuses. It should be noted that Schedules E and F, referred to in

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<sup>1</sup>In various documents introduced into evidence in this matter, Norman Frederick's name appears as "Fredericks". Since the correct name is apparently "Frederick", all references to him in this determination shall be to the correct name regardless of how it appears on the particular document.

<sup>2</sup>While the agreement lists Norman Frederick as principal, Mr. Frederick did not sign the agreement in this individual capacity.

the agreement as a security agreement and UCC filings, were not annexed to the copy which was introduced into evidence at the hearing. Also not annexed was Schedule D which is referred to in the agreement as the form set forth for the bill of sale.

4. The promissory note given by Hermie's was secured by filing Uniform Commercial Code financing statements, forms UCC-1, which listed Hermie's as the debtor and DeSantis Music Schoolhouse, Inc. as the secured party (see, Division's Exhibit "J"). These forms were signed by Norman Frederick on behalf of the debtor and by Mario DeSantis for the secured party. The forms are undated.

5. On July 19, 1993, the Division of Taxation ("Division") received a Notification of Sale, Transfer or Assignment in Bulk (Form AU-196.10) from the seller, DeSantis Music Schoolhouse, Inc. which indicated that Hermie's was purchasing tangible personal property for a total sales price of \$10,000.00 and that the scheduled date of sale was August 1, 1993. Attached thereto was a copy of the asset purchase agreement (none of the schedules was included). On this form, Mario DeSantis was listed as the escrow agent.

6. On July 22, 1993, the Division issued a Notice of Claim to Purchaser to Hermie's which stated, in part, as follows:

"You are hereby notified that, in spite of any provisions contained in the sales contract, except as indicated in condition number two listed below, no distribution of funds or property, to the extent of the amount of the State's claim, may be made before the following conditions have been met:

1. The Department of Taxation and Finance has determined the seller's liability, if any.
2. Payment of such liability has been made to the Department (payment may be made from the funds being withheld in accordance with Section 1141(c) of the Tax Law).
3. This office has authorized you to release the funds or property.

Although an escrow fund is not mandated by law, to be protected as a purchaser from incurring an outstanding sales tax liability from the seller of this business, you should place the entire purchase amount in an escrow fund designated for the purpose of satisfying such liabilities. The escrow agent should be clearly instructed that no distribution of these funds can be made until the three conditions set forth in the second paragraph have been met."

7. On October 19, 1993, the Division issued a Notice of Determination to Hermie's in the amount of \$10,000.00, plus penalty and interest for a total amount due of \$11,295.83.

8. By check dated June 26, 1993 (see, Division's Exhibit "H"), Hermie's paid the sum of \$5,000.00 to Mario DeSantis. By check dated July 14, 1993 (see, Division's Exhibit "I"), Hermie's paid the sum of \$1,000.00 to Mario DeSantis.

9. On December 3, 1993, Hermie's made two additional payments to DeSantis, one payment in the amount of \$4,000.00 and the other in the amount of \$700.00 (see, Division's Exhibit "D"). Petitioner was given credit for the \$4,000.00 payment as evidenced by the Conciliation Order (CMS No. 134868), dated September 16, 1994, which reduced the assessment from \$10,000.00 to \$6,000.00, plus applicable penalty and interest.<sup>3</sup> The \$700.00 payment was applied to the return for the period ended August 31, 1993 which was filed in December 1993 (see, Division's Exhibit "G"). Tax due as shown on the return was \$646.31 and penalty and interest was \$53.69 for a total due of \$700.00.

10. As of July 9, 1993, DeSantis Music Schoolhouse East, Inc. had outstanding tax assessments totaling \$28,330.29, plus penalty and interest. These assessments were for the period ended May 31, 1990 and also for the period March 1, 1990 through February 28, 1992 (see, Division's Exhibit "D", Deferred Payment Agreement).

On July 9, 1993, DeSantis Music Schoolhouse East, Inc. made two payments to the Division (the checks were made payable to New York State Sales Tax). One check was in the amount of \$1,148.85 and the other in the amount of \$4,800.00 (see, Division's Exhibit "D").

As part of Division's Exhibit "D", along with copies of the aforementioned evidence of payment by DeSantis Music Schoolhouse East, Inc., was a copy of a letter from DeSantis' attorney, dated October 2, 1994, addressed to petitioner's representative, which stated that "[m]y client has advised me, however, that the \$6,000.00 was not received for ordinary purchases, but was received as a deposit regarding the bulk sale."

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<sup>3</sup>It is unclear from the record as to the reason why petitioner was given credit for this \$4,000.00 payment. The only apparent reason was that this payment was made to retire the promissory note and the right, title and interest in such promissory note had been assigned by Bonne Music to the New York State Department of Taxation and Finance (see, Finding of Fact "3").

11. The Division's records established that the payment of \$1,148.85 was applied against a sales tax return filed for the period ended May 31, 1993. This return, due on or before June 20, 1993, was filed on July 9, 1993 and indicated tax due of \$1,035.58, plus penalty and interest of \$113.27, for a total amount due of \$1,148.85.

The payment of \$4,800.00 was applied to Assessment No. L004763130-7 (see, Division's Exhibit "L") which was for the period ended May 31, 1990 (see, Division's Exhibit "D").

12. At some point prior to August 1, 1993, Norman Frederick received a Notice to Creditors, prepared by Bonne Music, for Mr. Frederick's signature. On the Notice to Creditors, the transferor's debts were estimated to be in excess of \$200,000.00, including a debt of \$53,000.00 to the Division. Mr. Frederick had no idea that Bonne Music had this amount of debt. Many of the creditors were dealers with whom Hermie's had been doing business for many years. Mr. Frederick turned over all of his documents to his accountant who advised him to retain an attorney since Mr. Frederick no longer wanted to buy the business. On August 19, 1993, Attorney Richard A. Reisman sent a letter to the attorneys for Mario DeSantis (see, Petitioner's Exhibit "4") which stated, in pertinent part, as follows:

"Without reiterating the various reasons for our belief that neither Mr. Fredericks, individually, nor Hermie's Music Store is obligated to consummate the proposed transaction with Mario DeSantis and Bonne Music, it is our position that Mr. Fredericks is entitled to be made whole. We recognize that Mr. DeSantis is not financially able to return the money that was paid down, nor to pay for the item supplied by Mr. Fredericks and sold by Mr. DeSantis. Therefore, Mr. Fredericks would like to receive inventory as compensation."

13. By letter dated September 3, 1993, Mr. DeSantis' attorneys responded by stating that Mr. DeSantis was ready, willing and able to close on the July agreement with Hermie's and was willing to extend the closing date until September 20, 1993 (see, Petitioner's Exhibit "5").

14. Attorney Reisman's letter of September 15, 1993 to Mr. DeSantis' attorney (see, Petitioner's Exhibit "6") stated, in part, as follows:

"Mr. Fredericks informs me that your client agrees that the transaction and employment contemplated by them will not be consummated, and that they are re-negotiating the purchase of the remaining inventory."

It is important that the parties' understanding be accurately reflected in a written contract, that Mr. Fredericks receive good title to the goods, and that Mr. Fredericks be protected against the claims of creditors."

15. The Division's records show that DeSantis Music Schoolhouse, Inc. filed its final sales tax return for the quarter ended August 31, 1993 and that this taxpayer was never reactivated after this period (see, Division's Exhibit "K").

***SUMMARY OF THE PARTIES' POSITIONS***

16. When he discovered the total amount owed by Bonne Music to creditors, Norman Frederick refused to purchase the assets of the business, to operate the store and to hire Mario DeSantis as previously agreed upon. Since he had already paid \$6,000.00 and had signed a promissory note for \$4,000.00, Mr. Frederick agreed to accept inventory in exchange for the \$10,000.00. Other than this inventory, he did not purchase any of the business assets, i.e., fixtures, receivables or use of the business name.

Petitioner maintains that Hermie's regularly purchased items of music inventory from other music stores and often sold some of its inventory to music stores. This inventory purchased from DeSantis was for resale and within the ordinary course of business and, therefore, did not fall within the bulk sale provisions of the Tax Law.

In the alternative, if it is determined that the transaction does fall within the definition of a bulk sale, petitioner contends that there is no sales tax due since the Division has been paid the entire \$10,000.00, plus the \$700.00 sales tax due thereon, which it paid to Mr. DeSantis.

17. The Division maintains that Hermie's failed to withhold funds from the seller as required by Tax Law § 1141(c) and, instead, paid all of the purchase price to the seller. The amount of tax owed by the seller exceeded the sum of \$10,000.00. Accordingly, Hermie's is liable for all tax, penalty and interest determined to be due from the seller since it has not shown, by clear and convincing evidence, that a bulk sale did not occur.

Despite the fact that it is not in dispute that Hermie's made payment to DeSantis in the amount of \$10,700.00 and that Bonne Music paid nearly the same amount to the Division, Hermie's is not entitled to a reduction in the amount of its assessment. This is true because,

pursuant to the provisions of 20 NYCRR 537.4(i), the remaining liability of the seller exceeded the liability of the purchaser and the purchaser's liability, therefore, continues without diminution. Hermie's failed to comply with the bulk sale filing requirements (it did not file the Notice of Bulk Sale and did not withhold funds from the seller as required). Moreover, some of the payments made by DeSantis are not traceable to the amounts paid by Hermie's and some accompanied returns and were, therefore, not subject to that particular liability.

A. Section 1141(c) of the Tax Law provides, in pertinent part, as follows:

"Whenever 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 ten days before taking possession of the subject of said sale, transfer or assignment, or paying therefor, notify the tax commission by registered mail of the proposed sale and of the price, terms and conditions thereof whether or not the seller, transferrer or assignor, has represented to, or informed the purchaser, transferee or assignee that he owes any tax pursuant to this article, and whether or not the purchaser, transferee, or assignee has knowledge that such taxes are owing, and whether any such taxes are in fact owing.

"Whenever the purchaser, transferee or assignee shall fail to give notice to the tax commission as required by the preceding paragraph, or whenever the tax commission shall inform the purchaser, transferee or assignee 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, transferee or assignee is required to transfer over to the seller, transferrer or assignor shall be subject to a first priority right and lien for any such taxes theretofore or thereafter determined to be due from the seller, transferrer or assignor to the state, and the purchaser, transferee or assignee is forbidden to transfer to the seller, transferrer or assignor any such sums of money, property or choses in action to the extent of the amount of the state's claim . . . . For failure to comply with the provisions of this subdivision the purchaser, transferee or assignee, in addition to being subject to the liabilities and remedies imposed under the provisions of article six of the uniform commercial code, 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, transferrer or assignor, except that the liability of the purchaser, transferee or assignee shall be limited to an amount not in excess of the purchase price or fair market value of the business assets sold, transferred or assigned to such purchaser, transferee, or assignee, whichever is higher, and such liability may be assessed and enforced in the same manner as the liability for tax under this article."

B. 20 NYCRR 537.1(a)(1) defines "bulk sale" to mean "any sale, transfer or assignment in bulk of any part or the whole of business assets, other than in the ordinary course of business, by a person required to collect tax and pay the same over to the Department of Taxation and Finance."

C. 20 NYCRR 537.1(b) provides that "[t]he term business assets as used in this part means any assets of a business pertaining directly to the conduct of the business, whether such assets are intangible, tangible or real property. Any asset owned by a corporation is a business asset."

D. 20 NYCRR 537.1(d) provides as follows:

"(1) The phrase 'ordinary course of business' as used in this Part means any function, operation or transaction which is done ordinarily or customarily in the course of business. All the facts and circumstances surrounding the transaction must be examined to ascertain whether the transaction is in the ordinary course of business.

(2) Where a major part of the business assets are sold, such sale is clearly not in the ordinary course of business and is a bulk sale."

E. In the present matter, petitioner contends that, upon learning of the poor financial condition of the seller, i.e., the approximately \$200,000.00 owed to creditors, it decided not to follow through with the terms of the July 8, 1993 written agreement. More specifically, Hermie's no longer wished to purchase the store fixtures and accounts receivable of Bonne Music and did not desire to operate the business, using the name "Bonne Music".

It must be noted that petitioner's contention that the sale was never consummated is supported by no independent evidence whatsoever. Other than some correspondence between the attorneys for the seller and the purchaser (see, Division's Exhibit "D"; Petitioner's Exhibits "4", "5" and "6") which, standing alone, does not establish that the transaction was canceled, the only other evidence presented was the testimony of Norman Frederick. Mr. Frederick's testimony, especially during cross examination, could best be described as confused and somewhat evasive. While the Division does not contend that petitioner took over and continued to operate Bonne Music in Syracuse, it is unclear what petitioner received in exchange for its payments of \$10,000.00. If, as petitioner maintains, the agreement was terminated prior to closing, it is also unclear why petitioner made additional payments in December 1993. Mr. Frederick's explanation that he made the \$4,000.00 payment to retire the promissory note is contradicted by the letter from his attorney on August 19, 1993 (see, Petitioner's Exhibit "4") in which it was stated that it was the attorney's belief that neither Mr. Frederick nor Hermie's was

obligated to consummate the proposed transaction and that Mr. Frederick was entitled "to be made whole". If the sale was, in fact, terminated, why then would additional payments have been made approximately four months later. The letter from petitioner's attorney on September 15, 1993 (see, Petitioner's Exhibit "6") basically states that the transaction was not terminated but was merely renegotiated, i.e., the employment of Mr. DeSantis would not take place and perhaps certain items originally intended to have been purchased would be excluded. However, it is clear from the letter that Hermie's still desired to purchase the remaining inventory of Bonne Music. This letter also indicates that petitioner's attorney desired to have the understanding of the parties reflected in a written contract, but no contract was produced nor was an explanation offered as to whether or not such a contract was ever executed.

In summary, the evidence presented herein, consisting solely of the testimony of Norman Frederick, is insufficient to establish that the bulk sale contemplated in the written agreement of July 8, 1993 was never consummated. Even assuming, arguendo, that Hermie's never purchased the fixtures, accounts receivable and right to use the name "Bonne Music", it is uncontroverted that Hermie's did purchase a substantial portion (if not all) of Bonne Music's inventory. The corporation, DeSantis Music Schoolhouse, Inc., filed its final sales tax return for the quarter ended August 31, 1993 and the business was not reactivated (see, Finding of Fact "15"). Examples in the regulations indicate that a sale of assets as part of the liquidation of the seller's business is considered to be within the purview of Tax Law § 1141(c) (20 NYCRR 537.1[d][2], examples 16 and 17; see also, Matter of Neptune Corp., State Tax Commission, September 29, 1982). While it may have been in the ordinary course of business, as Norman Frederick stated, to purchase inventory from other similar businesses and to sell some inventory to these businesses as the need arose, this sale by Bonne Music to Hermie's was a sale of a substantial portion, if not all, of Bonne Music's inventory. As stated in 20 NYCRR 537.1(d)(2), where a major part of the business assets are sold (here the assets consisted of inventory), such a sale is not in the ordinary course of business and is a bulk sale. Accordingly, whether the transaction was consummated in its original form (as set forth in the written agreement of July

8, 1993) or was subsequently modified to include a sale of inventory only, it was a bulk sale governed by the provisions of Tax Law § 1141(c) and the regulations promulgated thereunder.

F. As indicated in Conclusion of Law "A", supra, a purchaser who fails to give timely notice of the proposed sale to the Division becomes personally liable for the payment of the seller's unpaid sales and use taxes to the extent of the purchase price or the fair market value of the assets sold, whichever is higher (Harcel Liquors, Inc. v. Evsam Parking, Inc., 48 NY2d 503, 423 NYS2d 873, 875).

In the present matter, although Hermie's, the purchaser, did not give timely notice of the proposed sale to the Division, the seller did so on July 19, 1993 (see, Finding of Fact "5"). In Matter of WIXT-TV, Inc. (Tax Appeals Tribunal, August 2, 1990) the Tribunal addressed the purpose of the filing of the notice of bulk sale, stating:

"The purpose of such notification is (1) to provide the Division with adequate time, prior to the consummation of the sale, to determine whether there are any taxes due the State from the seller of a business and (2) to preserve the Division's ability to collect any of the seller's liability from the consideration for the assets of the business being transferred. Filing of the notice as required by the statute also serves to protect the purchaser from personal liability for any outstanding sales tax obligations of the seller. Finally, the filing of the notification of sale puts the Division on notice with regard to sales tax which may be due on the sale in bulk of business assets."

It must be determined that the notice filed by the seller complied with the requirements of Tax Law § 1141(c). While petitioner did not file the notice, the above-stated purposes of the filing requirements were satisfied and the Division of Taxation timely (July 22, 1993) issued a Notice of Claim to Purchaser (see, 20 NYCRR 537.6[a][3]). In addition, the Division timely (October 19, 1993) notified petitioner of the total amount of taxes which it claimed to be due from the seller (see, 20 NYCRR 537.6[c]).

Although the notification of the bulk sale is deemed to have been properly filed, petitioner did not comply with the provisions of Tax Law § 1141(c) because it paid \$6,000.00 to the seller prior to notification to the Division. Failure by the purchaser to withhold the funds from the seller made the purchaser personally liable for the payment of any and all sales and use taxes due from the seller (20 NYCRR 537.4[a][1]). Therefore, Hermie's was liable for taxes

due from Bonne Music to the Division up to the amount of the purchase price (\$10,000.00), since the seller's liability exceeded the purchase price (see, Finding of Fact "10"; 20 NYCRR 537.4[c]).

G. As to the payments made by petitioner of \$5,000.00 on June 26, 1993 and \$1,000.00 on July 14, 1993 (see, Finding of Fact "8"), both payments were made prior to the bulk sale notification given to the Division by the seller on July 19, 1993. Accordingly, petitioner can receive no credit against its liability despite the fact that a substantial portion of these payments were subsequently paid over to the Division by the seller.

With respect to the remaining payments made by petitioner to the seller on December 3, 1993, petitioner has already been credited with the \$4,000.00 payment (see, Finding of Fact "9"). The \$700.00 payment was made to the seller long after petitioner had received the Notice of Claim (on July 22, 1993), which clearly informed it not to make any distribution of funds until certain conditions had been met (see, Finding of Fact "6"), and had received the Notice of Determination (on October 19, 1993) as well. In spite of having received these notices from the Division, petitioner disregarded them and made these payments directly to the seller in December 1993. Accordingly, petitioner is not entitled to a credit against its liability. This is true even though the seller paid the \$700.00 to the Division with its return for the quarter ended August 31, 1993 (see, Finding of Fact "9"). The seller's remaining outstanding liability still exceeded the liability of petitioner; therefore, petitioner's liability is not reduced (20 NYCRR 537.4[i]).

H. As indicated in Finding of Fact "7", supra, the Notice of Determination issued to petitioner included penalty and interest. In Matter of Velez v. Division of Taxation (152 AD2d 87, 547 NYS2d 444, 447), the Court stated that "the Legislature did not intend that a bulk sale purchaser be liable for the penalties and interest assessed against the seller" pursuant to Tax Law § 1141(c). Therefore, penalty and interest imposed against petitioner cannot have accrued prior to the date the notice was issued to petitioner (October 19, 1993).

In Matter of Gaughan (Tax Appeals Tribunal, May 14, 1992), the Tribunal took Velez one step further by stating that the penalty and interest began to accrue from the point at which petitioner received the notice of determination. In the Division's brief in Gaughan, it conceded that it was Division policy to consider the date of receipt of a notice to be the date five days after the date the notice is issued, rather than the issuance date itself. Therefore, in the present matter, since the Notice of Determination was issued to Hermie's on October 19, 1993, the date of receipt is deemed to have occurred on October 24, 1993 which shall be the accrual date of the penalty and interest imposed against petitioner.

I. The petition of Hermie's Music Store, Inc. is granted to the extent indicated in Conclusion of Law "H"; the Division of Taxation is directed to recalculate the amount of penalty and interest assessed on the Notice of Determination, as modified by the Conciliation Order dated September 16, 1994, issued to petitioner on October 19, 1994 accordingly; and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York  
May 2, 1996

/s/ Brian L. Friedman  
ADMINISTRATIVE LAW JUDGE