

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
HERMIE'S MUSIC STORE, INC.	:	DECISION
	:	DTA No. 813242
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.	:	

Petitioner Hermie's Music Store, Inc., 727 State Street, Schenectady, New York 12305, filed an exception to the determination of the Administrative Law Judge issued on May 2, 1996. Petitioner appeared by Daniel C. Ertel, CPA. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Brian J. McCann, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a letter in lieu of a formal brief along with a copy of its brief submitted to the Administrative Law Judge below in opposition. Petitioner filed a reply brief which was received on June 25, 1996, and began the six-month period for the issuance of this decision. Petitioner's request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

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

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

At all times relevant hereto, Norman Frederick¹ 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.

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.

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,² 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

¹In 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.

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

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 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.

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.

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.

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."

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.

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.

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.³ 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.

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

³It 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, above).

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."

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").

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."

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").

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."

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").

OPINION

In his determination below, the Administrative Law Judge concluded that a bulk sale occurred pursuant to Tax Law § 1141(c) based upon petitioner's failure to establish that the transaction was never consummated. The Administrative Law Judge determined that even though petitioner, as purchaser, failed to notify the Department of Taxation and Finance (hereinafter the "Department") of the proposed sale, the seller, DeSantis Music Schoolhouse East, Inc. d/b/a Bonne Music, did notify the Department satisfying the notification requirement set forth in Tax Law § 1141(c).

However, the Administrative Law Judge stated that even though the notification of the bulk sale was deemed to be properly filed, petitioner did not comply with the provisions of Tax Law § 1141(c) due to the fact that it paid \$6,000.00 to the seller prior to the notification to the Department of the bulk sale. The Administrative Law Judge reasoned that, based upon 20 NYCRR 537.4(a)(1), the failure by petitioner to withhold the funds from the seller made it personally liable, as the purchaser, for the payment of any and all sales and use taxes due from the seller. Therefore, relying on 20 NYCRR 537.4(c), it was concluded that petitioner was

liable for taxes due from DeSantis Music Schoolhouse East, Inc. to the Division up to the amount of the purchase price since the seller's tax liability exceeded the amount of the purchase price.

Lastly, the Administrative Law Judge concluded that petitioner was not entitled to a credit in the amount of the \$6,000.00 paid to the seller even though this money was paid over to the Department to satisfy the seller's tax liability. The Administrative Law Judge stated that since the payment of \$5,000.00 was paid to the seller on June 26, 1993 and \$1,000.00 was paid on July 14, 1993, both payments preceded the notification to the Department of the bulk sale on July 19, 1993 which prevents petitioner herein from being credited with the payments.

On exception, petitioner raised the same arguments as made to the Administrative Law Judge. Since the Administrative Law Judge adequately dealt with the issues below, we affirm the determination for the reasons set forth therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Hermie's Music Store, Inc. is denied;
2. The determination of the Administrative Law Judge is sustained;
3. The petition of Hermies Music Store, Inc. is granted to the extent of the Administrative Law Judge's conclusion of law "H" and in all other respects is denied; and

4. 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.

DATED: Troy, New York
December 26, 1996

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner