STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **ROBERT E. WEICHBRODT** **D/B/A McDONALD'S** 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 April 1, 1996 through June 30, 1996.	:	
In the Matter of the Petition of **R. E. WEICHBRODT, INC.** 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, 1996 through August 31, 1996.	:	DETERMINATION DTA NOS. 817950 AND 817951

Petitioner, Robert E. Weichbrodt d/b/a McDonald's, 56 Water Street, Lyons, New York 14489, 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 April 1, 1996 through June 30, 1996.

Petitioner, R. E. Weichbrodt, Inc., 56 Water Street, Lyons, New York 14489, 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, 1996 through August 31, 1996.

A consolidated hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 183 East Main Street, Rochester, New York, on April 18, 2001, at 10:30 A.M., with briefs to be submitted by November 2, 2001, which date began the

six-month period for the issuance of this determination. Petitioners appeared by William R. Nojay, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Cynthia E. McDonough, Esq., of counsel).

ISSUES

I. Whether the transfer of assets in exchange for stock from a sole proprietor to an existing corporation entirely owned by that sole proprietor is a retail sale subject to sales tax.

II. Whether, if the transfer is a retail sale, the Division of Taxation correctly determined the tax due on the sale of the tangible assets.

FINDINGS OF FACT

1. Petitioner, Robert E. Weichbrodt d/b/a McDonald's ("Weichbrodt" or the "sole proprietorship"), owned and operated four McDonald's restaurants in Wayne County, New York. Petitioner, R.E. Weichbrodt, Inc. (the "Corporation"), an S-corporation for tax purposes, owned and operated four McDonald's restaurants in Monroe County, New York.

2. The Corporation was formed in April 1993. It was authorized to issue 200 shares of its common stock. During the period in issue, Weichbrodt owned 100 percent of the issued and outstanding shares of the Corporation. In addition, Weichbrodt was the sole director, president and CEO of the Corporation.

3. The eight McDonald's restaurants were managed and supervised by Weichbrodt and three other employees on a consolidated basis. The payroll function for all eight restaurants was performed by one individual. Purchasing was done on a consolidated basis; advertising and marketing were conducted on a consolidated basis. Each individual restaurant operated separately.

4. Weichbrodt and the Corporation maintained separate books and records and filed separate Federal income tax returns, New York State income tax and corporation franchise tax returns, and New York State sales tax returns. The books and records of the sole proprietorship and the corporation were maintained by the same personnel at a business office in Lyons, New York.

5. As of June 30, 1996, Weichbrodt transferred all assets of the sole proprietorship to the Corporation. On or about June 13, 1996, the Corporation filed a Notification of Sale, Transfer or Assignment in Bulk with the Division of Taxation ("Division"). The notice explained that "Robert E. Weichbrodt, 100% owner of R.E. Weichbrodt, Inc., is transferring all of the assets of his sole proprietorship into the corporation." (Original entirely capitalized.) The stated price of all assets transferred, including tangible personal property, was shown as zero.

6. In August 1998, the Division began a sales tax audit of the sole proprietorship for the period September 1, 1995 through June 30, 1996. In the course of that audit, the Division reviewed the bulk sale notification form and determined that petitioners had incorrectly stated the value of the assets transferred as zero.

7. Shortly after the audit of Weichbrodt began, the Division commenced an audit of the Corporation for the period September 1, 1995 through August 31, 1998. The two audits were performed on a consolidated basis.

8. The Division explained to petitioners that it considered the transfer of assets from Weichbrodt to the Corporation to be a retail sale subject to sales tax. Accordingly, the Division requested a copy of the contract of sale in order to determine the fair market value of the tangible personal property transferred to the Corporation. Petitioners, through their representative, James F. Shaw, CPA, disagreed with the Division's position and argued that the transfer of assets from

the sole proprietorship to the solely-owned S-corporation was not a retail sale. The contract of sale was not provided to the Division.

9. On November 17, 1998, James F. Shaw, acting under powers of attorney from both Weichbrodt and the Corporation, executed consents to extend the period of limitations for assessing sales taxes against Weichbrodt and the Corporation for the period September 1, 1995 through June 30, 1996 to March 20, 1999. The auditor requested that a second consent be executed to extend the assessment period, but petitioners' representative refused to further extend the assessment period.

10. The Division then estimated sales tax due on the transfer of assets from the sole proprietorship to the Corporation based on information taken from the balance sheet of the sole proprietorship.[1]

11. The sole proprietorship's balance sheet for June 1996 showed total fixed assets as follows:

Equipment	$1,846,915.84
Signs	156,183.58
Leasehold improvements	1,018,902.05
Vehicles	151,721.21
Land	10,000.00
A/D Equipment	(1,541,591.13)
A/D Signs	(142,017.10)
A/D Leasehold improvements	(469,652.72)
A/D Vehicles	(91,431.87)
Total fixed assets	$ 939,029.86

[1] Petitioners claim that "[t]he Division assessed tax at the balance sheet amount as reported on the Corporation's federal income tax return on Form 1120S, Schedule L, page 4." This assertion is not supported by the record. Asked how he determined the value of the assets for the bulk sale, the auditor testified: "It was fairly simple. I just looked at the balance sheet of the d/b/a prior to the transfer, and I took the total asset value minus the accumulated depreciation and the land value, and that was it, really." (Transcript, p. 21.)

12. To calculate the value of the assets transferred to the Corporation, the Division subtracted accumulated depreciation ("A/D" above) and land value from the stated book value of the fixed assets as shown above. The book value of the fixed assets was deemed to be the sales price of the assets at the time of the transfer, $929,029.86, with a sales tax due on that amount of $65,032.09.

13. On March 4, 1999, the Division issued statements of proposed audit changes for sales and use taxes due to Weichbrodt and the Corporation in connection with the asset transfer which took place on June 30, 1996. Each notice asserted tax due of $65,032.09 plus penalty and interest.

14. The Division issued a Notice of Determination, dated February 25, 1999, to Robert E. Weichbrodt assessing sales taxes due for the period ended June 30, 1996 of $65,032.09 plus interest of $24,510.88 and a negligence penalty pursuant to Tax Law § 1145(a)(1)(i) of $19,509.63.

15. The Division issued a Notice of Determination, dated February 25, 1999, to R. E. Weichbrodt, Inc., assessing sales taxes due for the period ended August 31,1996 of $65,032.09 plus interest of $22,704.45 and both a negligence penalty pursuant to Tax Law § 1145(a)(1)(i) and a substantial underreporting penalty pursuant to Tax Law § 1145(a)(1)(vi) resulting in a total penalty of $26,012.84.

16. In connection with a conciliation conference held in November 1999, petitioner submitted to the Division a copy of an Assignment, Bill of Sale and Assumption Agreement between Weichbrodt and the Corporation (the "transfer agreement"). The transfer agreement provides for the transfer of all assets owned by the sole proprietorship, as set forth on Schedule A, to the Corporation "in consideration for ten (10) shares of common stock of R.E.

WEICHBRODT, INC." The transfer agreement also states: "Transferee hereby assumes and agrees to discharge and perform the liabilities and obligations of Transferor referred to in Schedule A annexed to this Transfer Agreement."

17. As pertinent, Schedule A provides: "The fixed assets set forth herein are all valued at the 'net book value of such assets' on the date of transfer, and are transferred subject to any debts and liabilities associated with said personal property." Schedule A then goes on to list the fixed assets, furniture, equipment and miscellaneous supplies owned by Weichbrodt at each of the four McDonald's restaurants owned and operated by the sole proprietorship.

18. Prior to the June 1996 transfer, Weichbrodt entered into a series of four loan agreements with Golden Managers Acceptance Corporation, c/o Texas Commerce Bank National Association ("Golden Managers"). The four promissory notes from Golden Managers were executed by Weichbrodt personally. The promissory notes were secured by security agreements

covering all of the personal property – goods, equipment, machinery, furnishings, appliances, etc. – located at the four McDonald's restaurants owned by Weichbrodt as a sole proprietor.

19. At the time of the transfer, Weichbrodt remained the borrower on the four promissory notes and remained personally liable for payment of the loans. The assets of the four McDonald's restaurants continued to serve as security for the loans. Before and after the transfer, the Corporation made payments on the loans.

20. In 1997, the four loans from Golden Managers were refinanced into one loan. The Corporation is liable for the loan and Weichbrodt acts as the guaranty.

21. Schedule L of the Corporation's 1996 Federal income tax return, the balance sheet, shows various changes in assets and liabilities from the beginning to the end of the tax year. The

acquisition of Weichbrodt's assets and liabilities are reflected in this balance sheet. Total assets increased from $1,151,465.00 to $3,023,829.00. This includes increases in cash, inventories, depreciable assets and intangible assets. The value of depreciable assets, including buildings, increased from $810,015.00 to $4,713,000.00. The liabilities of the Corporation also increased after the transfer, especially in the category of notes and bonds payable in more than a year. This amount increased from $777,872.00 to $1,952,109.00. Line 23 of Schedule L is for paid-in capital or capital surplus. There are no entries on this line. The value of capital stock is shown as $73,227.00 at the beginning and end of the year.

Schedule M-2 is an Analysis of Accumulated Adjustments Account. It shows an addition of $115,604.00 to the Shareholder's Equity Account.

SUMMARY OF THE POSITIONS OF THE PARTIES

22. Petitioners' primary argument is that the transfer of assets did not constitute a retail sale because Weichbrodt did not receive "material consideration" for the transfer of assets to the Corporation. They argue that the stock received by Weichbrodt was of no financial or economic value to him and, therefore, that the issuance of stock in exchange for Weichbrodt's assets did not create a taxable transaction.

23. If it is found that there was consideration for the transfer so that a taxable sale occurred, then petitioners argue that the Division incorrectly calculated the value of the consideration given. They calculate the value of the consideration by the sum of the increase in shareholder's equity as reported on the Corporation's Federal income tax returns, $115,604.00. This reflects the total adjustment to the Corporation's net worth arising from the transfer of the Weichbrodt assets as calculated by petitioners' accountants.

24. The Division argues that it reasonably calculated the consideration for the transfer based on the book value of the assets prior to the transfer. The Division also claims that the Corporation assumed Weichbrodt's debts and liabilities under the terms of the transfer agreement and that this assumption of debt constitutes consideration subject to sales tax.

25. The Division claims that petitioners have not shown that the determination was unreasonable or incorrect. It argues that the value of the tangible property is not decreased by the amount of the liabilities assumed by the Corporation.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every retail sale of tangible personal property unless otherwise excluded. As relevant here, a "sale" is defined as "[a]ny transfer of title or possession or both, . . . conditional or otherwise, in any manner or by any means whatsoever for a consideration." (Tax Law § 1101[b][5].)

Without question, title and possession of the assets of the four McDonald's restaurants owned by the sole proprietorship were transferred to the Corporation as of June 30, 1996 in exchange for stock. Petitioners' contention that no sale took place because the 10 shares of stock received by Weichbrodt lacked economic or financial value is rejected.

It is well-established that the transfer of assets from a sole proprietorship to a corporation in exchange for stock, where both entities are wholly owned by the same individual, constitutes a sale subject to sales tax (***Matter of Sunny Vending Co. v. State Tax Commn.***, 101 AD2d 666, 475 NYS2d 896; ***see also, Matter of P-H Fine Arts Ltd. v. New York State Tax Appeals Tribunal***, 227 AD2d 683, 642 NYS2d 232 [artwork transferred by a company to an existing corporation, both owned by the same individual, in exchange for 10 shares of stock, is a sale as defined in Tax Law § 1101[b][4]). In ***Sunny Vending***, the petitioners were a sole proprietorship

and a corporation wholly owned by the sole proprietorship. All of the assets of the sole proprietorship were transferred to the corporation in exchange for 100 additional shares of common stock issued to the sole proprietor, and the books and records of both entities were adjusted to reflect the transfer. The court held that this transaction was reasonably deemed by the State Tax Commission to be a sale within the meaning of Tax Law § 1101(b)(4). The Court noted that "the broad and inclusive language of the taxing statute 'clearly expresses an intent to encompass most transactions involving the transfer or use of commodities in the business world'" (***Sunny Vending Co. v. State Tax Commn.***, ***supra***, quoting ***Matter of Albany Calcium Light Co. v. State Tax Commn.***, 55 AD2d 502, 504, 391 NYS2d 201 ***revd on other grounds*** 44 NY2d 986, 408 NYS2d 333).

There, as here, the petitioners argued that there was no consideration for the transfer and, therefore, no sale because "the individual received nothing of value since he owned 100% of the corporate stock both before and after the transfer." Petitioners' argument is essentially the same. In light of the longstanding precedent of ***Sunny Vending***, it is meritless.

B. The only remaining issue is whether the Division correctly determined the sales tax due on the sale of assets. As stated above, the sales tax is imposed upon "receipts" from every retail sale (Tax Law § 1105[a]). For purposes of article 28, a receipt is defined as "[t]he amount of the *sale price* of any property . . . valued in money, whether received in money or otherwise" (Tax Law § 1101[b][3]; emphasis added). Since the Corporation did not pay cash for the assets it received and the parties did not value those assets in the transfer agreement, the Division was required to determine the "sale price" of the assets using the information available to it (Tax Law § 1138[a][1] [where a taxpayer's records are incorrect or insufficient to permit an exact computation of tax due, the Division is authorized to estimate the tax liability on the basis of

available information]; ***see also***, ***Matter of Ristorante Puglia, Ltd. v. Chu***, 102 AD2d 348, 478 NYS2d 91, 93; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451, 452). Any method used to estimate taxable receipts must be reasonably calculated to reflect the taxes due (***Matter of Ristorante Puglia, Ltd. v. Chu***, ***supra***; ***Matter of W. T. Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, 157, ***cert denied*** 355 US 869, 2 L Ed 2d 75) but exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, 177, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Lefkowitz***, Tax Appeals Tribunal, May 3, 1990). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, ***supra***).

C. The Division based its calculation of sale price, or taxable receipts, on the fair market value of the assets transferred. It deemed the fair market value to be the depreciable value of the assets as shown on the balance sheet of the sole proprietorship just prior to the transfer. This is a reasonable method for determining the sale price of the assets transferred.

As noted above, a taxable sale is defined, as relevant here, as a "transfer of title or possession or both . . . in any manner or by any means whatsoever for a consideration." The Division's sales tax regulations define "consideration," in part, as follows:

> The term consideration includes monetary consideration, exchange, barter, the rendering of any service, or any agreement therefor. *Monetary consideration includes assumption of liabilities*, fees, rentals, royalties or any other charge that a purchaser, lessee or licensee is required to pay. (20 NYCRR 526.7[b]; emphasis added.)

Neither the Tax Law nor the Division's regulations contain guidance on how to value the consideration for assets transferred from a sole proprietorship to a corporation wholly owned by

the sole proprietor. However, the regulations do contain guidance in an analogous situation, a sale of assets between two related corporations: "[t]he sale of property by one related corporation to another related corporation is a retail sale, and taxable to the extent of the consideration paid, *or the fair market value, if the consideration paid is not an adequate indication of the true value of the property transferred*" (20 NYCRR 526.6[d][8][i]; emphasis added). The instructions given on the bulk sale form are consistent with both of these regulations. That form states as follows:

> If the sales contract does not provide a sales price for the assets, the amounts to be listed are the depreciable value for income tax purposes or the fair market value, whichever is higher. Do not reduce the sales price or valuation assigned by the amount of any mortgage or other liability assumed by the purchaser.

The Division's calculation of sales tax due from petitioners is consistent with the cited regulations and the instructions found on the bulk sale form. The sales contract between Weichbrodt and the Corporation did not provide a sales price for the assets; therefore, the sales price was determined to be the depreciable value of the assets for income tax purposes. The actual amounts were taken from the balance sheet of the sole proprietorship, not from the Corporation's Federal income tax return as petitioners claim. The Division did not reduce the depreciable value of the assets by the amount of Weichbrodt's indebtedness on the four Golden Managers loans. It estimated the sales price by reference to the book value of the assets on the date of transfer. This is a reasonable method for calculating the tax due. Inasmuch as the Division's method for calculating the tax due is a reasonable one, petitioners have the burden to show that the sales price estimated by the Division is incorrect. They have not carried this burden.

D. Petitioners claim that the stock issued to Weichbrodt in exchange for the assets had a value equal to the sum of the increase in shareholder's equity as reported on the Corporation's Federal income tax returns, $115,604.00. Thus, if the issuance of the stock constitutes consideration for the transfer, the value of the consideration is argued to be $115,604.00. Moreover, petitioners argue, the corporation did not assume Weichbrodt's liability under the Golden Managers notes following the transfer of assets; therefore, petitioners discount the Division's claim that the Corporation's assumption of debt associated with the transferred assets constitutes additional consideration. These arguments are rejected.

As the Division points out in its brief, petitioners failed to provide any credible evidence that the value of the assets transferred to the Corporation is lower than the book value of the assets as shown on the balance sheet of the sole proprietorship just prior to the transfer. More important, petitioners' assertion that the increase in shareholder equity should be used as a basis for calculating the sales tax due is in conflict with its claim that the corporation did not assume any of Weichbrodt's debt. Shareholder equity did not increase by the book value of the transferred assets because Weichbrodt's liabilities were transferred to the Corporation along with the tangible assets of the four McDonald's restaurants. Had the Corporation not assumed the debts of the sole proprietorship, the value of the shareholder's equity account would have been greater. Finally, the market value of the tangible assets is not offset by any debt secured by the value of those assets.

E. The petitions of Robert Weichbrodt d/b/a McDonald's and R.E. Weichbrodt, Inc. are denied, and the notices of determination, dated February 25, 1999, are sustained.

DATED: Troy, New York
January 31, 2002

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE