

# The New Jersey Bulk Sales Notification Process for Pass-Through Sellers

by Russell Bershad, Peter J. Ulrich and Ivette P. Alvarado



**T**he application of the New Jersey Bulk Sales Act<sup>1</sup> to transactions involving a seller that is a pass-through entity or a disregarded entity for income tax purposes raises a number of practical complications and a few not entirely answered questions for sellers and their counsel.

The Bulk Sales Act was adopted in 2007 as an expansion of a pre-existing New Jersey sales tax collection statutory provision and applies broadly to the sales of business assets, including real property, other than in the ordinary course of business of the seller. It requires the purchaser of such assets to notify the state of New Jersey, Department of the Treasury, Division of Taxation of the impending asset sale via submission of a notification of sale, transfer or assignment in bulk (Form C-9600). Generally, upon receipt of the Form C-9600, the division reviews the tax records of the seller and either issues a clearance letter to the buyer stating there are no outstanding taxes due or, if it determines there are outstanding tax liabilities, the division issues a letter requiring the buyer escrow a certain amount at closing to cover such liabilities. The public policy behind the Bulk Sales Act is to give the state one last chance to collect tax debts from a New Jersey taxpayer, especially since the sale transaction may provide a one-time source of liquidity.

While the Bulk Sales Act does not require any submissions from the seller, practitioners counseling sellers should be sure their clients complete an asset transfer tax declaration (Form TTD or TTD) and be sure to submit a TTD to the division sufficiently in advance of the closing. The TTD discloses information regarding the seller's amount realized, adjusted tax basis, and estimated income tax liability on the pending sale, and is used by the division to better calculate (and often reduce) the required bulk sales escrow.

As described, the bulk sales notification process is for the most part straightforward. In the case of a seller that is a pass-through entity, however, where the taxpayers bearing the tax

liability triggered by the sale may consist of several parties several tiers up in the ownership chain, completion of the TTDs may be more cumbersome and the number of ways to minimize the escrow exposure may multiply.

### **Variety of Pass-Through Sellers and Transactions**

The structure of the sale of assets, including real estate, can take varied forms. Multiple TTDs will need to be submitted when multiple entities sell their assets or their interests in multiple entities in a single transaction. The seller may be a partnership or limited liability company with any number of partners or members consisting of individuals or entities. The seller could be an S corporation with several shareholders. In all of these cases, each pass-through equity holder is required, and normally will be motivated, to complete a separate TTD. In fact, the division's Form TTD requires that the filer submit a current membership directory if a partner or member is not an individual, and the division will calculate the allocation of gain on the sale among the partners or members.

These partners, members and S corporation shareholders could be New Jersey tax residents or nonresidents for New Jersey income tax purposes. If nonresidents, the pass-through entity itself is normally required to 'withhold' any income tax liabilities of such nonresidents related to income allocations of the entity, entirely separate from the bulk sale escrow requirements.<sup>2</sup> The instructions to Form TTD state that once a pass-through entity possesses more than five nonresident Schedule K-1 recipients, the filer is required to submit a current membership directory, and the division will calculate the allocation of gain on the sale and determine the withholding tax.

In addition, a seller that is a property owner could be a disregarded entity (DRE) for income tax purposes, or the transaction might involve the sale of

membership interests in a DRE. In that event, the parent of the DRE must fill out the TTD. Alternatively, an upper-tier pass-through entity may sell the interests of a lower-tier entity that owns real estate, such as a single purpose entity (SPE), and each of the partners or members of that upper-tier entity, each a Schedule K-1 recipient, will need to complete a separate TTD. Furthermore, the sale of real estate by tenants-in-common (each a TIC), which not only may include individuals but also entities holding title as TICs, will require the filing of multiple TTDs.

### **Completing Form TTD**

As noted above, sellers and their counsel should diligently attend to the preparation and submission of TTDs, particularly when pass-through entities are involved, because the monetary impact can be substantial.

Form TTD acts as a practical bridge between the information provided by the buyer via the Form C-9600 and the actual tax and escrow implications to sellers on the sale of the subject property or assets. The seller's goal in the bulk sales process implicitly is to minimize the bulk sales escrow, and the TTD is often the most effective tool to help the seller accomplish that goal. Completion of the TTD will often require the involvement of the seller's accountant or chief financial officer. The process should be started early, in particular with regard to pass-through entities, transactions involving a multitude of selling entities or entities or properties with a complex income tax history.

There are a number of factors that may reduce, perhaps significantly, the net income tax due to the state as a result of any particular transaction, including:

- Selling costs
- Adjusted tax basis of sold property
- Seller is engaging in an IRC Section

1031 transaction

- Available net operating losses of seller or seller's partners or members
- Other current-year losses of seller
- Other current-year losses of selling members or S corporation shareholders

Sellers and counsel alike should note that pursuant to N.J.S.A. 54:50-8, TTDs are not public documents when filed; they are confidential and privileged and are, for the most part, legislatively exempt from New Jersey's Open Public Records Act.<sup>3</sup> Thus, sellers that wish to keep their submitted tax and financial information confidential should submit their TTDs directly to the division, instead of through the purchaser, as is often the practice.

### **Buyer Concerns on Buying Assets from Flow-Through Structures**

The sale of business assets by flow-through entities can also raise some unique questions under the Bulk Sales Act, beginning with whether or not the Bulk Sales Act applies. For example, just because the owners of a pass-through entity are New Jersey taxpayers, if the property or business is entirely outside of New Jersey, Form C-9600 should not need to be submitted, although the authors are aware of no guidance from the division on this point. Another question is whether a sale qualifies as being in the ordinary course of business of a seller, and thus not subject to the Bulk Sales Act. Often when the seller is a DRE, the parties need to look at whether the parent of the DRE meets the ordinary course exemption. If it does, the single sale of the subject asset by the DRE should not require compliance with the notification requirements of the Bulk Sales Act. For example, a residential home developer may well acquire various properties via separate SPEs, each of which is a DRE. At the time of the sale of individual units, the buyer should be concerned with respect to both the tax liabilities of the SPE and the par-

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ent of the SPE. If the parent is engaged in the business of selling such properties in the ordinary course of business, the sale by the SPE of similarly held property should be free of the bulk sale notification requirements. A conservative buyer may still wish to file Form C-9600, outline those facts, and request tax clearance.

### **Escrow Amount Takes into Account All Outstanding State Taxes**

Much of the foregoing discussion addressed the state income tax liabilities triggered by a sale of assets. Consistent with the Bulk Sales Act, the division will analyze, and the required escrow will need to take into account, all outstanding deficiencies and return delinquencies relating to all applicable state taxes, including corporation business tax, sales and use tax, gross income tax withholding obligations, litter tax, petroleum taxes, plus any outstanding interest or penalty assessments and any taxes assessed against the seller under any transferee liability provisions of law, such as those applicable to the survivor of a corporate merger or under a common law transferee liability theory.

### **Forgoing Filing the Bulk Sales Notice—Considerations**

In cases when the state tax liabilities of a seller are slight, quantifiable, and verifiable, the seller is a good credit risk, or there is an ongoing relationship between the buyer and seller that will likely continue after the closing, the buyer may decide to forgo filing the Form C-9600 notification. By statute, the division's position is simply that the buyer does so at the risk of bearing full transferee liability for all of the seller's outstanding state tax liabilities and deficiencies, including income tax triggered by the sale, regardless of the extent to which they exceed the purchase price, and regardless of whether they are determined and assessed by an audit that takes place after the subject sale.<sup>4</sup>

Besides transferee liability for the buyer, there is no monetary or other penalty for failure to comply with the Bulk Sales Act. If the buyer decides to skip the Bulk Sales Act notification process, after some due diligence and analysis of the exposure, the prudent buyer typically will want a broad indemnification for all the seller's tax liabilities owed to the state (not just on the gain from the sale of the assets or property), and probably the income tax liabilities of the partners, members or S corporation shareholders triggered in a sale of assets by a flow-through entity. Most critically, the buyer will need to be careful about who provides such indemnity. An unsecured indemnity from an SPE selling real estate to a buyer, for example, will be of little value since the entity's only asset is the real estate being sold. Thus, the buyer should ask for indemnification from a creditworthy source with liquidity, such as, perhaps, the SPE's parent.

In conclusion, the relatively straightforward bulk sales process becomes more complicated for parties on both sides of the sale when the seller is a pass-through entity, but careful consideration of the facts, proper application of the law and, where appropriate, correct submission of bulk sales forms will assist sellers and buyers in navigating the Bulk Sales Act under such circumstances. ☞

**Russell Bershad** is co-chair, and **Ivette P. Alvarado** a director, in the real property and environmental department of Gibbons P.C. **Peter J. Ulrich** is a director in the Gibbons corporate department.

### **ENDNOTES**

1. N.J.S.A. 54:50-38.
2. See N.J.S.A. 54:10A-15.6 – 15.8.
3. N.J.S.A. 47:1A-1 *et seq.*
4. See *GABGEO v. Director, Div. of Taxation*, 23 N.J. Tax 38 (2006).