



Real Property, Trust and Estate Law Section Newsletter

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Commentary: **Should the New Jersey Bulk Sales Act Apply to Residential Closings?**

by F. Bradford Batcha

Despite recent amendments to the New Jersey Bulk Sales Act, there still exists a major economic risk for anyone buying a home in New Jersey. The act was originally created in 1966 as a part of the Sales and Use Tax Act to assist the state in collecting tax revenue by requiring the buyer of any business assets to notify the state in writing 10 days prior to the closing.¹ The state would then issue a tax clearance letter permitting the sale or would issue an escrow letter requiring certain funds be withheld from the seller's proceeds in order to satisfy any tax obligation of the seller.

In 2007, the act was expanded beyond sales and use tax to cover all state taxes and, therefore, applied to all real estate holdings.² The theory was that except for a personal residence, all real property is generally held for investment and, therefore, is a business asset. Since that time anyone purchasing real property, which had been used as a business asset, must also comply with the act and submit notice to the state 10 days prior to a closing. In practice, the notice requirement can be a major pitfall for an unsuspecting buyer who is not aware of the law. While purchasers of commercial property tend to be both sophisticated and represented by counsel, that does not hold true in the world of residential real estate in New Jersey. In fact, most residential buyers are unaware of the law and often, especially in South Jersey, are not represented by counsel.

While many risks of purchasing residential property can be avoided by obtaining a thorough home inspection and purchasing title insurance, unless the buyer has an attorney, they are unlikely to be aware of the notice requirements of the act. Failing to file the bulk sales notice leaves the buyer personally responsible for all of the seller's tax liability to the state of New Jersey. This liability is not limited to possible capital gains tax from the sale, but rather it covers any and all tax liability of the seller, including payroll tax, sales tax or income tax the seller may owe at the time of the sale. And,

it is not even capped by the sale price of the property. Failing to comply with the notice provisions of the act is a personal obligation of the buyer and, therefore, does not create a lien on the property. Since it is not a lien, title insurance companies do not insure against this risk, because it does not affect title. Therefore, a title company would not require a buyer to file the required notice prior to closing.

Fortunately, in 2011, an exemption was created for residential properties of one and two families that were owned by an individual, married couple, trust or estate. The exemption eliminated the need to determine if these properties were, in fact, a business asset. It also reduced the need to send in the notice for thousands of residential transactions each year. Unfortunately, the Bulk Sales Division interpreted the word 'individual' to mean single individual. This meant that if there was more than one individual who owned a residential property, except for married couples, the property was subject to the act under the theory that two or more individuals were a business partnership. This interpretation of the act identified any true partnerships where two or more individuals owned residential property for business investments. However, the interpretation was so broad that it also covered property owned by related individuals (siblings or parent/child) who may have lived together or inherited property. Thus, there was still a burden on many buyers to send out the bulk sales notice as a prerequisite to the purchase of residential real estate. The 2018 amendment expanded the exemption to include 'individuals,' so that now unmarried individuals, multiple individuals, trusts or estates or any combination of these are exempt from bulk sales reporting. The 2011 and 2018 amendments to the act represent significant progress towards exempting all residential properties; however, those residential properties that are owned by limited liability companies (LLCs) or corporations are still subject to the act.

The author's main objection lies with the remedy for failing to send out the notice. Certainly, the purpose of the remedy is to create a deterrent for buyers so they will not neglect to send in the required notice. While the act does incentivize those who are sophisticated enough to understand the law to send in the proper notice prior to closing, most residential buyers are lay people who lack any knowledge of the act and may find themselves subject to the draconian remedy of becoming responsible for the seller's tax liability. If the act

had made these obligations a lien on the property, then title companies would insist on obtaining a bulk sales clearance letter prior to closing and could insure a buyer against any liability under the act. As it stands, since this is not a lien, title companies do not require that the act be complied with in order to insure insurance on residential properties.

This highlights the differences in closing practices for residential properties between northern New Jersey and southern New Jersey. In North Jersey, residential buyers are typically represented by attorneys who are well versed with the details of the act and send out the notices as required. However, in South Jersey it is customary for buyers not to engage attorneys to represent them in the purchase of residential property. Thus, in South Jersey there is no professional who is looking out for the buyer's interest with respect to complying with the act and sending out the required notice in advance of closing.

Take the following example: A couple from South Jersey who saved their entire life to purchase a new construction home chooses not to retain an attorney. Their title company does not mention the notice requirement of the act prior to the purchase. The seller is a builder holding title as an LLC, which is common for builders. This particular builder has not paid payroll or income taxes and stands to make a significant capital gain on this sale. All told, the builder's tax obligations exceed \$100,000. Under the act, if the buyer fails to send the required notice to the state 10 days prior to closing, they would become personally responsible for the \$100,000 tax debt of the builder. As a practical matter, the author is unsure if the Bulk Sales Division has ever pursued an innocent buyer similar to the one described in this example. Nevertheless, this is the state of the law for an unsuspecting buyer.

It seems to the author that the fair approach would be to exempt all residential one- and two-family properties regardless of the legal status of the seller, so the unsophisticated buyer will not become the target of a collection action from the state of New Jersey for the tax obligations of a derelict seller. If all one- and two-family residential properties were exempt, then only buyers of three or more family residential properties and commercial properties would be subject to the act. Those buyers are often more sophisticated and, more importantly, are generally represented by attorneys who will protect their interests.

The Bulk Sales Act is an effective way to collect tax dollars due to the state of New Jersey, but in the context

of residential real estate, an unsuspecting buyer can get stuck paying the tax debts of a derelict seller. The author believes the law should be revised to protect the innocent purchaser. Fortunately, the law has already created an exemption for all sellers of one- and two-family homes who are individuals, trusts or estates or any combination. In addition, many of the LLCs and corporations who sell properties are also exempt, since they are selling in the 'ordinary course of business.' The only remaining sellers subject to bulk sales notice are LLCs and corporations who do not meet the ordinary course of business exemption. It is often difficult, even for a sophisticated attorney, to determine if the ordinary course exemption is met. The risk is that if the attorney makes the wrong call, their client becomes liable. For this reason, most attorneys will err on the side of caution and file the notice, except in clear cases where the seller is a major known developer with multiple sales in the ordinary course of business.

The bottom line is that there are now only a limited number of residential sales that are subject to the Bulk Sales Act. However, they do exist, and the risk remains that a buyer will either not understand their obligation to send out the notice or will be convinced by a self-serving seller that they are exempt from the act. In either case, an innocent buyer could fall victim to the draconian remedy of the current Bulk Sales Act. For this reason, the author believes the act should be amended so that all one- and two-family residential properties should be exempt from the act, regardless of the ownership entity of the seller. The buyer's ability to purchase a home without the risk of becoming personally liable for the tax debts of a delinquent seller should outweigh the state's interest in collecting tax from corporate sellers of residential property in New Jersey. ■

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Endnotes

1. See N.J.S.A. 54:32B-22(c).
2. See N.J.S.A. 54:50-38.