

Bulk Sales – More Than Just a Payment of Tax

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The Maryland Bulk Sales Act imposes two duties (either directly or indirectly) on the purchaser and seller of a major part of a company's assets: (1) compliance with the notice requirements of the Bulk Sales Act, and (2) payment of a bulk sales tax.

(1) *Notice to Creditors*

Maryland is one of only seven states that continues to follow the original Article 6 of the Uniform Commercial Code (the "UCC") which regulates bulk sales. The Maryland Bulk Sales Act ("Bulk Sales Act"), contained in Title 6 of the Maryland Code, was intended to reduce the risk of a merchant obtaining credit from a lender, selling its tangible business assets in bulk and then absconding with the proceeds. A "bulk transfer" is defined as "any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory of an enterprise..." MD COMM. LAW §6-102(1). The Bulk Sales Act requires that a purchaser of a major part of the inventory of an enterprise that sells merchandise from stock, including restaurants, and sellers of alcoholic beverages, provide at least ten days' advance notice of the impending sale to the seller's creditors, thereby allowing the creditors an opportunity to protect their interests while the inventory is still owned by the seller. It also provides an opportunity for such creditors to take steps to require the purchaser to pay such creditors from the proceeds of the sale.

The Bulk Sales Act, like Article 6 of the UCC, imposes certain duties on the purchaser of a major part of the seller's assets. Specifically, there are five requirements:

(1) the purchaser must obtain from the seller a sworn list of its existing creditors;

(2) the purchaser and seller must prepare a detailed list of the property that is subject to the Bulk Sales Act;

(3) the purchaser must make the list of creditors and list of property available for inspection and copying by any creditor of the seller for six months after the transfer;

(4) as noted, the purchaser must notify each of the seller's creditors of the pending sale at least ten days before the purchaser pays for the property or the property is transferred, whichever occurs first; and

(5) the purchaser must assure that the proceeds of the sale are used to pay the creditors. Of course if the proceeds are not sufficient to fully pay the claims of all creditors, then the purchaser is required to distribute the proceeds pro rata to the creditors.

In addition, regardless of whether the seller lists the Comptroller of Maryland as a creditor or whether the buyer knows that the seller owes any sales or use tax, the purchaser is required to give notice of the sale to the Comptroller. The consequence of not notifying the Comptroller or retaining a sufficient portion of the purchase price to satisfy any tax obligation is personal liability on the part of the purchaser for any unpaid taxes.

Although burdensome for both parties, compliance with the Bulk Sales Act offers a very important protection for both the purchaser and the seller. If the purchaser complies with all the requirements of the Bulk Sales Act, the seller's creditors have no rights against either the purchaser or the purchased assets. In addition, the Bulk Sales Act imposes a six month statute of limitations on the creditors for any action against the seller. Accordingly, the creditors must bring any action for any alleged violation of the Bulk Sales Act within six months of the sale of the assets. Failure to comply with the Bulk Sales Act, however, renders the sale transaction ineffective against the seller's creditors, so that the creditors can proceed against the property in the hands of the purchaser even if the purchaser did not assume the underlying debts and has otherwise acted in good faith.

(2) Payment of Tax

As if the notice to creditors under the Bulk Sales Act and the burdens associated therewith were not enough, Maryland law also imposes a 6% sales and use tax, so that any sale of a business' assets (including transactions that trigger the Bulk Sales Act) requires the payment of this tax on the price of the tangible personal property sold. This tax applies to furniture and fixtures, computer software, business records, customer lists and non-capitalized goods and supplies. In addition, since 1992, the tax has applied to leases of retail food preparation equipment and sales of property consumed in preparing food for sale at restaurants, grocery stores, delicatessens and retail bakeries.

While one would think that the Bulk Sales Act, including the 6% tax on the price of the tangible assets, would deter purchasers from making purchases which trigger the Bulk Sales Act, asset sales do go on, and on a positive note, purchasers and sellers can mutually agree to waive the Bulk Sales Act's requirements of notice to creditors, but not the 6% tax. However, the consequence of waiving the requirements of the Bulk Sales Act is that creditors can seek to collect payment by placing a lien on the transferred property, even though at the time of creation of any such lien, title has passed to the purchaser. If a purchaser does elect to waive the requirements of the Bulk Sales Act, in order to reduce the risks associated with such a waiver the purchaser should, at a minimum, include indemnification provisions in the purchase contract whereby seller indemnifies the purchaser if a creditor places a lien on the property or collects payment from the purchaser. While waiver of the Bulk Sales Act could potentially create additional risk for the purchaser, such risk may be outweighed by the cumbersome nature of compliance with the Bulk Sales Act, especially if the purchaser is protected by adequate indemnification procedures in the agreement, and such waiver may allow the deal to get done more quickly.

If you need assistance with a business transaction or other legal matters, please contact one of our business transactions attorneys at (410) 727-6600 or by e-mail at:

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