STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **ROBERT E. CRABTREE** | : | DECISION<br>DTA NO. 813724 |
| for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law. | : | |

Petitioner Robert E. Crabtree, 1317 Post Road East, Westport, Connecticut 06880, filed an exception to the determination of the Administrative Law Judge issued on May 1, 1997. Petitioner appeared by Stern, Keiser, Panken & Wohl, LLP (Andrew I. Panken, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (David C. Gannon, Esq., of counsel).

Petitioner filed a brief in support of his exception. The Division of Taxation filed a brief in opposition and petitioner filed a reply. Oral argument, at petitioner's request, was heard on November 11, 1997 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

## *ISSUES*

I. Whether petitioner timely filed his Claim for Refund of Real Property Transfer Gains Tax.[1]

[1]The real property transfer gains tax imposed by Tax Law Article 31-B was repealed on July 13, 1996. The repeal applies to transfers of real property that occur on or after June 15, 1996 (L 1996, ch 309, §§ 171-180).

II. If so, whether, in calculating the consideration for the transfer of real property, it was proper for petitioner to include the value of a promissory note which petitioner claims was subject to a contingency which never occurred.

## *FINDINGS OF FACT*

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

Petitioner, Robert E. Crabtree, was the president and principal shareholder of Crabtree Automotive, Inc. ("Crabtree Automotive").[2] Crabtree Automotive was a holding company which owned the stock of approximately 12 automobile dealerships in the New Rochelle, New York area. Petitioner, doing business as Estree Company or Estree Co., was the sole owner of seven parcels of real property which were the principal places of business of Crabtree Automotive and its subsidiaries.

Several factors led petitioner to conclude that he should dispose of the New York dealerships and focus upon his business activities in Connecticut. He had six dealerships in Connecticut that were beginning to flounder because of a lack of a manager. Moreover, petitioner was told that if he went to Connecticut and agreed to run the company himself, he would be given a Lexus franchise. An additional consideration was that petitioner did not like the direction that the businesses in New York were headed.

Initially, petitioner received an offer for the dealerships from Saudi Arabians who were represented by an individual from Hong Kong. However, petitioner was concerned about the prospect of negotiating a deal with the Saudi Arabians because he thought that General Motors

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[2]The balance of the stock, not held by petitioner personally, was held by or in trust for members of petitioner's family.

and Ford might be unhappy at the prospect of a franchise being owned and run by foreign nationals. Consequently, the change in franchise ownership might not be approved by the respective automobile manufacturer.

After the foregoing offer was made, petitioner was approached by a person who said that he represented individuals who were interested in acquiring the automobile dealerships by purchasing the stock of Crabtree Automotive. The same individuals also wanted to purchase the real estate.

Petitioner found the second offer more attractive. These individuals offered more money than the Saudi Arabians. Furthermore, petitioner anticipated that the individuals making the offer would be approved by the automobile manufacturers. Additionally, petitioner felt that it was easier to sell the stock in a holding company and get approval from the respective automobile manufacturers for the transfer of ownership. Therefore, he began negotiations and reached an agreement with the individuals who made the second offer.

CA Acquisition Corp. ("CA Acquisition") was formed for the purpose of acquiring the stock and real property holdings of Crabtree Automotive and petitioner.

Petitioner and others, as sellers, entered into a Stock Purchase Agreement, dated June 19, 1989, whereby they agreed to sell their stock in Crabtree Automotive to CA Acquisition. The Stock Purchase Agreement provided that the "Initial Purchase Price" was to be the sum of the "Purchase Price Balance Sheet Amount" (defined as the total shareholder's equity reflected in the "Purchase Price Balance Sheet") and $1,000,000.00 in cash subject to the "Closing Date Balance Sheet Adjustment". The Purchase Price Balance Sheet was defined as the unaudited combined and consolidated balance sheet of Crabtree Automotive and subsidiaries as of May 31, 1989. The Stock Purchase Agreement defined the "Closing Date Balance Sheet Adjustment" as the

difference between the total stockholders' equity reflected in the "Closing Date Balance Sheet" and the "Initial Purchase Price".

Section 2.4(a) of the Stock Purchase Agreement set forth the steps which were to be taken by the purchaser to prepare, among other things, the balance sheet as of the "Closing Date" and the consolidated statements of income and stockholders' equity for the period January 1, 1989 through the "Closing Date". Section 2.4(b) of the Stock Purchase Agreement provided that in the event that the total stockholders' equity exceeded the initial purchase price, the purchaser was obligated to pay the difference to the sellers. If the initial purchase price exceeded the total stockholders' equity, the sellers were obligated to pay the difference to the purchaser.

Under section 9.2 of the Stock Purchase Agreement, the sellers agreed to indemnify the purchaser for the breach of any representation or warranty set forth in the Stock Purchase Agreement or any document delivered in connection with the Stock Purchase Agreement. Additionally, section 9.3(b) of the Stock Purchase Agreement contained a provision which stated:

> In addition the Purchaser shall have the right to set off such obligations at any time and from time to time against any obligation of the Purchaser, Holdings or any Subsidiary to pay money to any of the Sellers in connection with the transactions contemplated under this Agreement or otherwise, including, but not limited to, amounts payable to REC pursuant to the note described in Section 2 of the Real Estate Purchase Agreement and to REC or Joseph C. Crabtree pursuant to the payment obligations described in Section 3 of the Consulting and Non-Competition Agreement.

The Stock Purchase Agreement contained assurances that the financial statements fairly presented the financial condition and results of operations of Crabtree Automotive and its subsidiaries.

Petitioner, doing business as Estree Company and Estree Co., also entered into a Real Estate Purchase Agreement, dated July 10, 1989, wherein he agreed to sell the real estate used in the businesses operated by Crabtree Automotive and its subsidiaries. The sixteenth section of the Real Estate Purchase Agreement concerned indemnification and contained a section which provided:

> SECTION 16. Indemnification. (a) Seller hereby agrees to indemnify Purchaser and its affiliates and their respective officers and directors against and hold them harmless from any loss, liability, payment of a claim, damage or expense (including reasonable legal fees and expenses and all other costs and expenses incurred in investigating, preparing for or defending any proceeding, commenced or threatened, incident to the foregoing or to the enforcement of this Section 16) suffered or incurred by any such indemnified party to the extent arising from (a) any breach of any representation or warranty of Seller contained in this Agreement or in any document delivered in connection herewith which by the terms of Section 15 survives the Closing . . . .

This section further provided:

> The Purchaser shall have the right to set off such obligations at any time and from time to time against any obligation of Purchaser and its affiliates (including Holdings, its affiliates, and their respective successors) to pay money to Seller pursuant to the Note or otherwise. . . .

At the time of the closing, CA Acquisition executed a second mortgage note promising to pay Robert E. Crabtree the principal sum of $7,500,000.00 over ten years. The note was secured by a second mortgage made by CA Acquisition to Robert Crabtree. The third page of the note contained a paragraph which provided, in part:

> Maker shall have the right to offset obligations of Payee to pay money to Maker pursuant to the provisions of Article IX of the Stock Purchase Agreement, dated as of June 19, 1989, among Payee, Constance A. Markey, Margaret J. Lyster, the Trusts (as defined therein), Crabtree Automotive, Inc. and Maker, and Section 16 of the Real Estate Purchase Agreement, dated July 10,

> 1989, between Payee and Maker, or otherwise against the obligations of Maker to Payee under this Note or the Mortgagee.

Paragraph nine of the second mortgage stated:

> 9. Mortgagor shall have the right to offset obligations of Mortgagee to pay money to Mortgagor pursuant to the provisions of Article IX of the Stock Purchase Agreement, dated as of June 19, 1989, among Mortgagee, Constance A. Markey, Margaret J. Lyster, the Trusts (as defined therein), Crabtree Automotive, Inc. and Mortgagor, and Section 16 of the Real Estate Purchase Agreement, dated July 10, 1989, between Mortgagee and Mortgagor, or otherwise against the obligations of Mortgagor under this Mortgage or the Note.

Pursuant to section 8.3 of the Stock Purchase Agreement, petitioner and his son executed a consulting agreement whereby they agreed that, in exchange for being available to consult and refrain from competition, they would receive $1,000,000.00 at closing in addition to payments for five years following the closing. Each payment was to be the greater of two-thirds of the net profits or $500,000.00, unless the net profit was less than $500,000.00, in which event the minimum payment was $250,000.00. The parties agreed that the total payments under the consulting agreement would not exceed $6,350,000.00.

It was Mr. Crabtree's understanding that a breach of any representation or warranty, including an alleged false representation as to the financial status of the business, could lead to an offset of the note. Under these circumstances, petitioner was advised by his attorneys that there was a good possibility that the purchaser would offset the note. Therefore, it was recommended that petitioner determine if he would go forward with the transaction without consideration of the note. Petitioner decided that he would accept the second offer because, even without the note, he was receiving more money for the automobile dealerships than was offered by the Saudi Arabians.

The subject property was transferred on September 18, 1989 for a gross consideration of $21,900,000.00. Petitioner paid gains tax in the amount of $859,129.20 at the time of the closing. In calculating the gain subject to tax, petitioner included the $7,500,000.00 allocable to the promissory note.

The transaction by which the interests were transferred was structured as a stock sale. The significance of a stock sale was that the post-closing balance sheet became very important. The parties agreed that the purchaser would assume management of all of the dealership corporations at the time of closing, with the purchase price for the stock to be finally determined pursuant to a post-closing audit. The purchase price was based upon a closing date of December 31, 1989 for purposes of preparing the audit, which normally is not completed until several months after the start of the following year.

From August through December 31, 1989, the dealerships were operated by the purchaser. During this period the purchaser's representatives destroyed numerous books and records and adopted a new computer system which resulted in a complete disarray of the accounting records. As a result, petitioner's accountant was unable to complete the post-closing audit. The inability to complete the post-closing audit led the purchaser to exercise its offset rights to the full extent of the amount of the note. The purchaser's position was based upon section 9.2 of the Stock Purchase Agreement which provided for a right of indemnification in the event of a breach of a representation or warranty of the sellers. CA Acquisition took the position that there was a false representation because the seller overvalued the automobile dealerships. In furtherance of its position, the purchaser prepared an uncertified Preliminary Closing Date Balance Sheet which indicated that the sellers owed the purchaser in excess of $9,000,000.00.

When the purchaser exercised its offset rights, petitioner filed a lawsuit against the purchaser. The verified complaint was dated December 5, 1990. In response, the purchaser filed a petition in bankruptcy. Ultimately, petitioner never received any payment on the promissory note.

Petitioner filed a claim for a refund dated January 18, 1995 seeking $750,000.00 which represents that portion of the gains tax attributable to the note on which he did not receive any payment.

In a letter dated February 21, 1995, petitioner was advised by the Division of Taxation ("Division") that the claim for refund must be denied in its entirety. Among other things, the Division stated that the claim for refund was untimely since it was not received within two years of the date of payment. Further, the Division concluded that petitioner properly paid tax on the amount of the note.

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

In citing to Tax Law former § 1445(1)(a), the Administrative Law Judge stated that petitioner was required to file a claim for refund of gains taxes erroneously paid within two years from either the date of transfer or the date of payment, whichever date is later. In this case, the Administrative Law Judge found that both the date of payment and the date of transfer were September 18, 1989. Therefore, the Administrative Law Judge stated that petitioner had until September 18, 1991 to file his claim for refund. Since the refund claim was dated January 18, 1995, the Administrative Law Judge concluded that petitioner failed to timely file his refund claim.

Furthermore, the Administrative Law Judge noted that the outcome of the bankruptcy proceeding was irrelevant to the issue of whether petitioner filed a timely application for a refund

in this case pursuant to Tax Law former § 1445(1)(a). Moreover, the Administrative Law Judge mentioned that the record indicated that petitioner was aware of the default on the promissory note by December 5, 1990 and, therefore, petitioner could have timely filed his claim for refund at that time. Thus, the Administrative Law Judge sustained the Division's denial of petitioner's claim for refund.

***ARGUMENTS ON EXCEPTION***

Petitioner disagrees with the Administrative Law Judge's conclusion that he had until September 18, 1991 within which to file his claim for refund in this case. Petitioner argues that the amount of the consideration paid by him was contingent upon the completion of the post-closing audit. Petitioner argues that where the amount of consideration is contingent and will be based upon events subsequent to the transfer, such events must be considered in determining the amount of tax due. Since it was not until the transferee's bankruptcy proceeding concluded in late 1994 that petitioner knew with certainty that payments would not be made under the note, it is from the date of the bankruptcy that the two-year time frame within which to file his claim for refund should begin to run. Thus, petitioner argues that his claim for refund was, in fact, timely and should be granted in the amount of $750,000.00.

In response, the Division states that petitioner's assertion is without merit. The Division argues that Tax Law former § 1445(1)(a) is clear on its face and the language contained in such section requires that an application for refund be made within two years from either the date of transfer or the date of payment, whichever date is later. The Division points out that there is no provision providing for an alternative time frame for matters in bankruptcy.

In reply, petitioner asserts that the Division mischaracterizes his argument by claiming that petitioner states that the two-year time frame within which to file his claim for refund should

begin on the date that the bankruptcy proceeding concluded. Petitioner argues that his argument is based on Division procedure as outlined in TSB-M-86(4)-R. Petitioner states that this Technical Services memorandum clearly outlines that a claim for refund of taxes erroneously paid is proper once it is determined with legal certainty that the contingency will or will not occur (***see***, Petitioner's reply brief, p. 2). Petitioner avers that he erroneously included the face amount of the promissory note as consideration in his gains tax filings even though such note was subject to a contingency. Therefore, petitioner alleges that he did more than he was legally obligated to do and he paid gains tax on the contingent consideration. Petitioner states that he was not legally certain that he would not receive payment on the note until the bankruptcy proceeding concluded. Accordingly, petitioner claims that he has two years from that date within which to file his claim for refund and, thus, his claim for refund in this case was timely filed.

***OPINION***

Petitioner's argument on exception emphasizes that the promissory note was contingent consideration. We disagree. As set forth in the transferor and transferee questionnaires, the consideration for the transfer of the real property at issue was $21,900,000.00 (Exhibit "H"). Petitioner has failed to establish that the payment under the promissory note was contingent in nature. Therefore, having reviewed the record in its entirety, we find that the Administrative Law Judge adequately and completely dealt with the issue presented to him and we affirm his determination for the reasons set forth therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Robert E. Crabtree is denied;

2. The determination of the Administrative Law Judge is sustained;

3. The petition of Robert E. Crabtree is denied; and

4. The refund denial letter dated February 21, 1995 is sustained.

DATED: Troy, New York
April 23, 1998

/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