STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT E. CRABTREE	:	DETERMINATION 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 a petition 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.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on November 30, 1995 at 1:15 P.M., with all briefs to be submitted by November 8, 1996, which date began the six-month period for the issuance of this determination. Petitioner appeared by Stern, Keiser, Panken & Wohl, L.L.P. (Andrew I. Panken, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (David C. Gannon, Esq., of counsel).

ISSUES

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

II. 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

1. Petitioner, Robert E. Crabtree, was the president and principal shareholder of Crabtree Automotive, Inc. ("Crabtree Automotive").[1] 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.

2. 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.

3. 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 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.

4. 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.

5. 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

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

automobile manufacturers for the transfer of ownership. Therefore, he began negotiations and reached an agreement with the individuals who made the second offer.

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

7. 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".

8. 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.

9. 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. "

10. 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.

11. 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. . . ."

12. 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."

13. 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."

14. 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.

15. 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.

16. 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.

17. 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.

18. 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.

19. 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.

20. 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.

21. 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.

SUMMARY OF THE PARTIES' POSITIONS

22. In his brief, petitioner summarizes his legal position as follows:

> "Tax Law Section 1440(1)(a) defines 'consideration' to mean 'The price paid or required to be paid for real property or any interest therein. . . .' The 'consideration' of $7,500,000 in the form of the face value of the Note was neither paid nor required to be paid as a result of the interrelated offset provisions and thus does not constitute 'consideration'. Furthermore, payment of the Note by its terms was contingent on there being no breach of the related Stock Purchase and Real Estate Purchase Agreements. The Buyer declared (as was its unilateral right) Petitioner to be in breach of the Agreements by supplying false financial data and making false representations as to Automotive's financial condition, thereby nullifying Buyer's obligation to make payment, which of course rendered the Note valueless." (Petitioner's brief, pp. 8-9.)

23. Petitioner submits that the buyer's adjustment in its favor was neither a subsequent event nor a dollar-for-dollar offset of an assumed liability for a fixed amount of a required note payment. According to petitioner,

> "it was an integral part of a contractual procedure involving a complicated set of financial statements which procedure, according to the Buyer, evidenced a breach of warranties as to financial condition entitling Buyer to reduce unilaterally the face amount of the Note to zero." (Petitioner's brief, p.12; emphasis in original.)

24. Petitioner contends that an error was made in the original gains tax filing by including as consideration the face value of the note which was contingent upon a post-closing audit. According to petitioner, under the Division's own procedure with respect to contingent payments, there is no obligation to pay gains tax on a contingent sum until the contingency has been met so that the sum is due and owing to the seller. Petitioner asserts that he did more than he was required to do and that this should not be held against him.

25. In response to the foregoing, the Division contends that the refund claim, which was filed more than five years after the date of transfer and the date of payment, is untimely. With respect to the merits of petitioner's argument, the Division contends that the validity of the basis

upon which the purchaser decided to exercise the offset provision of the stock purchase agreement is not relevant to this matter. It is submitted that the purchaser's default on the promissory note, which was premised upon its exercising the Stock Purchase Agreement offset provision, did not constitute a contingency for purposes of determining consideration under the gains tax. According to the Division, the closing date balance sheet adjustment related solely to the stock sold pursuant to the stock purchase agreement. In essence, it is the Division's position that petitioner elected to sell his interests in three separate transactions and that the offset provision in the stock purchase agreement is not relevant for gains tax purposes. The Division argues that this provision was simply a method of satisfying petitioner's obligations under the indemnification provisions of the stock purchase agreement and did not alter the consideration paid or required to be paid for the interest in real property.

26. In his reply brief, petitioner first takes issue with the Division's statement that petitioner chose to sell his interests in three separate transactions. According to petitioner, the testimony and evidence all establish that the stock sale, the real estate sale and the consulting agreement were part of one integrated sale. Petitioner next reiterates his position that the alleged breach of a representation or warranty in the Stock Purchase Agreement gave rise to a default which resulted in a right of indemnification and rendered the promissory note valueless. Petitioner stresses that the purchaser declared the note void ab initio and contends that the buyer exercised a unilateral right of offset claiming that its own Preliminary Closing Date Balance Sheet indicated that the stock purchase price was inflated by an amount exceeding $9,000,000.00. According to the buyer, petitioners alleged breach of representations and warranties invoked the contingency provision of the note and rendered it valueless. Petitioner submits that the buyer's obligation to make payment on the note could not be fixed until the post closing audit procedure was completed.

27. With respect to the statute of limitations argument, petitioner refers to TSB-M-86(4)R for the proposition that when the consideration paid for real property is unknown or subject to contingencies at the time of transfer, the contingent future payment is not included in

determining the consideration received at the time of payment. Petitioner next reiterates his argument that the payments under the note were contingent upon the nonexercise by the buyer of its unilateral right to withhold payments based upon the result of the post-closing audit procedure. It is petitioner's position that the face value of the note and therefore the amount to be added to the known consideration could not be determined on the date of transfer because it was subject to this contingency. Petitioner submits that it was not until the buyer's bankruptcy proceeding was concluded that he knew with finality that payments would not be made on the note. Petitioner contends that the bankruptcy was not a subsequent event under the Cheltoncort[2] line of cases, but a defensive maneuver by the buyer to protect itself against a possible adverse outcome of the post-closing audit procedure.

28. It is petitioner's position that, although he was not required to do so, he added the contingent future consideration to the known consideration as of the date of transfer. Therefore, petitioner maintains that he did more than he was legally obligated to do and the Division is now seeking to punish him for making a premature payment of gains tax. Petitioner posits that if the Division's position is sustained, it will be unjustly enriched.

29. With respect to the merits, petitioner reiterates his argument that the consideration was contingent because the face amount of the note was not required to be paid until an agreement was reached by the parties as to the valuation of the automobile dealerships as part of the post-closing audit procedure. According to petitioner,

> "[s]ince (1) the face value of the note did not constitute 'consideration' for Gains Tax purposes when delivered and (2) the contingency involved in this transaction, i.e., the resolution of the post-closing audit procedure in Petitioner's favor never occurred, the amount of $7,500,000 should not be included in any final calculation of Petitioner's Gains Tax liability." (Petitioner's reply brief, p.6.)

In support of his position, petitioner's brief makes reference to a determination of an Administrative Law Judge.

CONCLUSIONS OF LAW

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[2]Matter of Cheltoncort Company (Tax Appeals Tribunal, December 5, 1991, confirmed 185 AD2d 49, 592 NYS2d 121).

A. Tax Law former § 1445(1)(a) provided as follows:

"General. A person claiming to have erroneously paid the tax imposed by this article may file an application for a refund within two years from either the date of transfer or the date of payment, whichever is later."

B. Here, the record shows that the date of transfer and the date of payment was September 18, 1989. Therefore, petitioner had two years or until September 18, 1991 to file a claim for refund. Since the claim for refund was dated September 18, 1995, it is clear that the claim for a refund was untimely and properly denied. In view of the clear language of Tax Law former § 1445(1)(a), the outcome of the bankruptcy proceeding has no bearing on the question of whether petitioner filed a timely application for a refund. It is noted that the evidence in this case shows that petitioner was aware of the default on the note by December 5, 1990 (see, Finding of Fact "19"). Therefore, the facts show that he could have filed a timely claim for a refund. Since he failed to do so, the merits of the petition need not be addressed.

C. The petition of Robert E. Crabtree is denied.

DATED: Troy, New York
May 1, 1997

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE