STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MOHONK OIL COMPANY, INC.	:	DETERMINATION DTA NO. 822274
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 2006 through August 31, 2006.	:	

Petitioner, Mohonk Oil Company, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 2006 through August 31, 2006.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on December 10, 2008 at 10:30 A.M., with all briefs submitted by April 8, 2009, which date began the six-month period for the issuance of this determination. Petitioner appeared by Thomas R. DiGovanni, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUE

Whether the transfer of assets to a dormant corporation qualified for the exemption from sales and use tax provided for in Tax Law § 1101(b)(4)(iv)(D).

FINDINGS OF FACT

1. The Division of Taxation issued to petitioner, Mohonk Oil Company, Inc., a Notice of Determination, dated July 27, 2007, which asserted additional sales tax due for the quarter ended August 31, 2006 in the sum of $28,830.12 plus interest. The basis for the Division's assertion of

additional tax was petitioner's failure to file a bulk sales notice upon its transfer of assets to a corporation in exchange for stock and other property.[1]

2. The transfer in issue was made by petitioner, Mohonk Oil Company, Inc., to Mohonk Oil and Propane, Inc., on or about August 14, 2006 and was the culmination of many years of developing a corporate strategy for several corporations, planning its execution and negotiating with several potential merger and acquisition partners.

3. From an historical perspective, which is important in understanding the transaction under review, one must examine the business climate and industrial culture in the Hudson Valley within which oil and propane products were sold prior to August 14, 2006.

4. Heritagenergy (NY) Inc. was formed during the early 1970s and was the product of mergers of businesses owned by the Garraghan and Davenport families. Its president was R. Abel Garraghan.

5. As the industry evolved throughout the 1990s, Heritagenergy (NY) recognized that margins and growth opportunity in the industry were significantly greater in the marketing of propane than fuel oil. As of 1999, there had been less consolidation among propane businesses which presented growth opportunities for fuel oil companies looking to expand into that market, a circumstance which began a search by Heritagenergy (NY) for a suitable partner to assist it in gaining greater market share in the propane business.

6. Mr. Kenneth Davenport, a co-owner of Heritagenergy (NY), who had worked at the company in various capacities since 1987, testified that negotiations were begun with Van Etten Oil Company of Monticello, New York, in February 1999 and continued through the winter of

[1]The assets transferred as "other property" were subject to tax, which was asserted and was paid. The amount of tax in dispute is that associated with the transfer for the stock in the corporation. Neither the value of the assets transferred nor the calculation of tax thereon is in dispute.

2000. Van Etten not only provided the opportunity to expand propane operations but also included the acquisition of a customer list which would enhance fuel oil and propane sales. However, the deal did not materialize and the search continued.

This time frame was unusual for merger negotiations since fuel oil and propane businesses generally are too busy during the heating season to devote time to anything other than fuel delivery. The result is that time that can be expended on mergers and acquisitions normally falls between April and October.

7. In 2003, Heritagenergy (NY) approached Kimlin Propane Company, Inc., of Gardiner, New York, a company with which it had done business for 12 to 15 years, "through-putting" product (filling its tanks) through Kimlin's facility. Kimlin's owner had approached Heritagenergy (NY) several times over the years, but made overtures in earnest in the fall of 2003. Although Kimlin's financial statements and appraisals of its property, both real and personal, were provided in anticipation of the sale, its president ultimately disclosed that he had a silent partner and chose to purchase the partner's share and remain in business independently.

Subsequently, in 2005, Heritagenergy (NY) attempted to acquire parts of the fuel and propane distribution business of Colonial Coal Yard, Inc., but the deal was never consummated.

8. During the period within which Heritagenergy (NY) was negotiating with Kimlin Propane, David Davenport, cousin to Kenneth Davenport, discovered a business opportunity which would allow him to expand his business, petitioner, Mohonk Oil Company, Inc., into the propane sector. David Davenport had owned petitioner since 1998 and had acquired a customer list from Comfort Care Oil in 1998 and an oil and propane business from a company called "Appler."

9. After acquiring Appler, it was necessary for petitioner to find property that was zoned for the storage of propane tanks. David Davenport, petitioner's president, located property on Steves Lane in Gardiner, New York, coincidentally owned by Comfort Care Oil, in close proximity to businesses operated by Kimlin Propane and Majestic Propane, and, in 2001, purchased the site and moved Mohonk Oil Company there. Petitioner then entered into an agreement with Majestic Propane and its owner, Mr. Rick Majestic, to supply petitioner with propane from his terminal. This relationship remained intact until Mr. Majestic sold the business in 2006.

10. Mr. Majestic informed David Davenport, at about the same time petitioner entered into the agreement to purchase its propane supply from Majestic's terminal, that he was interested in selling his business to him. This offer was particularly attractive because it would provide a customer list of propane consumers which could also be serviced for fuel oil and it included Majestic's propane terminal, whose value lay in the difficulty in obtaining zoning for a new one.

11. Although the offer was very appealing, David Davenport did not have the financial resources to complete a deal of this magnitude. Since David Davenport had worked at Heritagenergy (NY) from 1987 to 1995, and his father had been a partner in the business, he knew that Heritagenergy (NY) was interested in expanding its propane business, and approached them with the idea of joining him in the deal with Majestic.

12. Based on the close relationship between the Garraghan and Davenport families and the good working relationship forged over decades in the fuel business, Heritagenergy (NY) was receptive to the idea and joined David Davenport in discussions of the venture in the fall of 2001 and the spring of 2002.

13. On October 25, 2002, Mr. Abel Garraghan, president of Heritagenergy (NY), incorporated Heritagenergy LP Gas, Inc.,[2] in furtherance of the plan to acquire Majestic Propane. In addition, Heritagenergy (NY) applied for and received a line of credit with Key Bank in Newburgh, New York, in May 2003 to finance the deal.

14. The U.S. income tax returns for an S corporation filed on behalf of Heritagenergy LP Gas, Inc., for the fiscal years ended March 31, 2003, 2004 and 2005 indicate no sales or cost of goods sold, no income or loss and the payment of $100.00 in taxes and licenses each year. In addition, the returns stated the sole shareholder for these fiscal years was Mr. R. Abel Garraghan.

15. It was not until the spring of 2006 that Majestic Propane finally agreed to consummate the deal and, with the help of financing from Heritagenergy (NY), Mohonk Oil Company, Inc., acquired Majestic Propane. On or about August 14, 2006, the assets acquired were transferred to Mohonk Oil and Propane, Inc. (formerly Heritagenergy LP Gas, Inc.), which was then allegedly owned by Patrick Garraghan (25%), Kenneth Davenport (25%) and David Davenport (50%), although there is nothing in the record which explained the transfer of shares to these gentlemen from the sole shareholder, R. Abel Garraghan.

16. Mr. David Davenport testified that, in his experience, it was not uncommon for acquisition and merger deals in this industry to take several years, since they involved the sale of family businesses and often involved the retirement of individuals who had to resolve many issues before the final sale could take place. In addition, due to preoccupation with fuel oil and gas delivery between October and April, the window of time available for negotiations in earnest was limited, thereby extending the time necessary to close a deal of this nature.

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[2]This corporation changed its name to Mohonk Oil and Propane, Inc., in June 2006 primarily to take advantage of Mohonk Oil Company's market share, name recognition and good will in the region.

SUMMARY OF THE PARTIES' POSITIONS

17. The Division of Taxation argues that the transfer of assets from Mohonk Oil Company, Inc., to Mohonk Oil and Propane, Inc., was a taxable sale pursuant to Tax Law § 1101(b)(5) and § 1105(a). Further, the Division does not believe the transaction qualifies for the exclusion of the transfer from the definition of retail sale pursuant to Tax Law § 1101(b)(4)(iv)(D) as a transfer to a corporation upon its organization in return for the issuance of stock. Rather, the Division contends that the transfer of assets to Mohonk Oil and Propane, Inc., by Mohonk Oil Company, Inc., several years after its incorporation was not eligible for the exclusion based upon the unequivocal words of the controlling statute, regulations and precedential case law.

18. Petitioner believes that it qualified for the exclusion from retail sales provided for in Tax Law § 1101(b)(4)(iv)(D) applicable to transfers to a corporation upon its organization in consideration for the issuance of stock because the statutory term "upon its organization" means at the commencement of corporate business or within a reasonable time thereafter. Petitioner argues that the term "reasonable time thereafter" is dependent upon the facts and circumstances of each matter and that the customs and practices in the fuel industry in petitioner's geographic region established that several years after the commencement of corporate business or incorporation is reasonable under the facts herein.

19. Petitioner disputes the Division's claim that Mohonk Oil and Propane, Inc., was merely a dormant corporation, newly created in 2002 and left inactive for four years prior to capitalization and the commencement of corporate business. Petitioner argues that the term "dormant" is not defined in the statute or regulations and maintains that a dictionary definition

should be adopted as the plain meaning of the word, which would exclude the organizational activity that preceded the transfer of assets to Mohonk Oil and Propane, Inc,. in August 2006.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every retail sale of tangible personal property. Retail sale is defined in Tax Law § 1101(b)(4) as a sale of tangible personal property to any person for any purpose, other than specific sales for resale and other sales not present herein. However, certain transactions are excluded from the definition of retail sale by Tax Law § 1101(b)(4)(iv)(D), which provides an exclusion for transfers of property to a corporation upon its organization in consideration for the issuance of stock.

B. The regulation at 20 NYCRR 526.6(d)(5)(i) repeats the statutory provision that transfer of property to a corporation upon its organization, in consideration for issuance of stock, is not a retail sale. However, the regulations also provide that corporate existence is deemed to begin upon the filing of the certificate of incorporation with the Secretary of State and that only transfers made at the time of the commencement of corporate business, or within a "reasonable time thereafter," while the corporation is still in the process of organizing, are eligible for the exclusion. (20 NYCRR 526.6[d][5][ii].)

In an effort to clarify the term "reasonable time thereafter," the regulations specifically state that transfers to a dormant corporation, which is being activated, are not eligible for the exclusion. (20 NYCRR 526.6[d][5][iii].) The following example is provided:

> Example 4: A corporation filed a certificate of incorporation with the Secretary of State on February 1, 1974. On March 10, 1976 it is decided that the corporation is to be activated, and on March 15, 1976 a stockholder transfers tangible personal property–a truck–to the corporation, in consideration of the issuance of shares of stock. The transfer is not excluded from the definition of retail sale, as it was not made upon the organization of the corporation.

A dormant corporation is generally defined as an inactive but legal corporation which is capable of being activated, but is presently not operating. (Black's Law Dictionary 439 [5th ed 1979].) This accurately describes Mohonk Oil and Propane, Inc. (formerly Hertagenergy LP Gas, Inc.) during the period October 25, 2002 until August 2006, the date the transfer of assets was made to it by Mohonk Oil Company, Inc.

The evidence revealed that Mohonk Oil and Propane, Inc. (formerly Hertagenergy LP Gas, Inc.) was incorporated on October 25, 2002. It filed U.S. income tax returns for an S corporation for the fiscal years ended October 31, 2003, 2004 and 2005 in which it indicated that it had one shareholder, R. Abel Garraghan, and had no business activity other than paying minimum taxes and fees due of $100.00. Since it was a dormant corporation, transferring assets to it four years after it was incorporated, in consideration for the stock held by the sole shareholder, E. Abel Garraghan, did not constitute a sale exempt from the definition of retail sale. (Tax Law § 1101[b][4][iv][D]; 20 NYCRR 526.6[d][5][iii]).

C. In ***Matter of P-H Fine Arts Ltd. v. New York State Tax Appeals Tribunal*** (227 AD2d 683, 642 NYS2d 232 [1996]), the Court found that the transfer of artwork to a "shelf corporation," one that is created and purposefully kept inactive until such time that it could be activated to operate under prior legislation, did not qualify for the exclusion from a retail sale where the corporation had been incorporated in February 1982 but did not receive tangible personal property in consideration for the issuance of stock until December 1983 and January 1984. The Court's reasoning, equally applicable to the instant matter, was stated as follows:

> Petitioner's argument that the Tribunal erred in ruling that the transfer of artwork from PCIE to Stepplong in exchange for issuance of Stepplong's common stock is excluded from sales tax is rejected. Tax Law § 1101(b)(4) (former [iii][D], now [iv][D]) excludes from the definition of a retail sale "the transfer of property to a corporation upon its organization in consideration for the issuance of its stock."

> Pursuant to 20 NYCRR 526.6(d)(5), the term "organization" can properly be equated with "incorporation" (***see, Matter of Noar Trucking Co. v. State Tax Commission***, 139 AD2d 869, 870-871, 527 NYS2d 597). The transfer of the artwork to Stepplong occurred approximately two years subsequent to Stepplong's incorporation. Thus, the Tribunal's determination in this respect is not irrational or unreasonable. Petitioners' claim that it is unfair to interpret the term "organization" with "incorporation" when a shelf corporation is involved ignores the fact that petitioners freely chose to do business through an existing shelf corporation instead of forming a new corporate entity.

Although Mohonk Oil and Propane, Inc., was not established as a shelf corporation, the timing of its creation and subsequent transfer of assets to it are analogous to such a corporation. The company was created to accommodate Hertitagenergy (NY)'s expansion into the propane industry in the region with a recognized and trusted name and a solid customer base. However, when the company was incorporated in October of 2002, it was not known when this would happen, thus introducing the risk of losing the exemption if there was no transfer of assets to the new company for the issuance of stock within a reasonable time thereafter.

D. The facts of each case must be carefully examined to determine what constitutes a "reasonable time thereafter." In ***Noar Trucking***, petitioner incorporated on February 1, 1980. Assets transferred to it by November 30, 1980, the end of its first fiscal year, were deemed exempt, but those occurring 10 to 21 months after its incorporation were not. In ***P-H Fine Arts Ltd***, two years between the incorporation and the transfer of assets was deemed an unreasonable amount of time and the exclusion was denied. Finally, as noted in Example 4 of 20 NYCRR 526.6[d][5][iii], a transfer of assets two years after incorporation did not qualify for the exclusion because the transfer was not made upon the organization of the corporation. Given the rationale in ***P-H Fine Arts***, none of these determinations of a "reasonable time thereafter" was either unreasonable or irrational.

In fact, the instant circumstances arguably are more compelling. Mohonk Oil and Propane, Inc., was incorporated and issued all of its stock to R. Abel Garraghan in October 2002 and then remained dormant and inactive for almost four years. Mr. Abel Garraghan remained its only stockholder until the stock of Mohonk Oil and Propane, Inc., was transferred to Patrick Garraghan, Kenneth Davenport and David Davenport in August 2006, transfers that were not documented in the record. The fact that upon its organization 100 percent of the stock of Mohonk Oil and Propane, Inc. vested in R. Abel Garraghan and remained in his name for almost four years before being transferred to Patrick Garraghan, Kenneth Davenport and David Davenport militates against a finding that the transfer of assets in exchange for the issuance of stock occurred upon the organization of the company.

Petitioner and Heritagenergy (NY) knew or should have known when they chose to create Mohonk Oil and Propane, Inc. in 2002 that, if it remained an inactive, dormant corporation for an extended period of time, the transfer of assets to it would not qualify for the exclusion set forth in Tax Law § 1101(b)(4)(iv)(D) and 20 NYCRR 526.6(d)(5). Ignorance of the law is not recognized as an excuse. (***Genesee Brewing Co. v. Village of Sodus Point,*** 126 Misc 2d 827, 834, 482 NYS2d 693, 700 [1984], ***affd*** 115 AD2d 313, 496 NYS2d 720 [1985]; ***accord Matter of Nathel v. Commissioner of Taxation and Fin.***, 232 AD2d 836, 649 NYS2d 196 [1996] [ignorance of the law is no excuse and a taxpayer is charged with knowledge of the law, including subsequent judicial interpretation thereof].)

In addressing the argument that equating the terms “organization” and “incorporation” was irrational and unreasonable, the Court in ***P-H Fine Arts***, noted that such a contention “ignores the fact that petitioners freely chose to do business through an existing shelf corporation instead

of forming a new corporate entity." That reasoning is pertinent here as well. Petitioner could have created a new corporation and qualified for the exclusion but freely chose not to do so.

E. Petitioner argues that the organization process for Mohonk Oil and Propane, Inc. was an extended and complex continuum that should qualify for the exclusion since the transfer of assets to it occurred during this process and was therefore "upon its organization." However, it is determined that adoption of this interpretation of the statute and regulations would render both meaningless. Petitioner's reliance on ***Noar Trucking*** is misplaced because there the period in question was 10 to 21 months after incorporation, "too late for entitlement to the corporate organizational exemption." Further, although the Court in ***Noar Trucking*** discussed corporate activity during the first fiscal year (nine months), e.g., conveyance of assets, capitalization, outstanding capital stock, gross receipts and wages, that period was not considered by the Court in its analysis because the Department of Taxation had already granted the exemption for that period. The Court rejected Noar's argument that the period 10 to 21 months after incorporation was "upon its organization." More importantly, the Court held that the Department could properly have found that petitioner began doing business on the date of incorporation and that to do so would have been a rational and reasonable interpretation of the statutory provision for the exemption set forth in Tax Law § 1101(b)(4)(iv)(D).

F. The petition of Mohonk Oil Company, Inc. is denied and the Notice of Determination, dated July 27, 2007, is sustained.

DATED: Troy, New York
August 27, 2009

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE