STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **GLENNA MICHAELS** for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2004.	DETERMINATION DTA NO. 823370

Petitioner, Glenna Michaels, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the year 2004.

On October 12, 2010 and October 21, 2010, respectively, petitioner, appearing by Hodgson Russ LLP (Timothy P. Noonan, Esq., of counsel), and the Division of Taxation, appearing by Mark F. Volk, Esq. (Christopher O'Brien, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by November 10, 2011, which date began the six-month period for the issuance of this determination. After due consideration of the documents and arguments submitted and all of the pleadings and proceedings had herein, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation properly accrued petitioner's gain from the sale of her Connecticut real estate to her resident period on the basis that petitioner became a New York resident prior to the closing date.

II. Whether the petitioner has shown reasonable cause for the abatement of penalties.

FINDINGS OF FACT

Petitioner submitted 15 proposed findings of fact, which have been incorporated into the findings below, except proposed findings 5 and 11 to the extent they are conclusory in nature and inappropriate for inclusion in findings of fact.

1. Petitioner, Glenna Michaels, purchased a home at 245 Byram Shore Road in Greenwich, Connecticut, on April 27, 1973.

2. On November 26, 1996, petitioner transferred ownership of the premises to the Glenna R. Michaels Qualified Personal Residence Trust (the Trust), of which petitioner was both settlor and sole trustee.

3. Pursuant to the Trust, petitioner was entitled to the use of the home and liable for the payment of all expenses relating to the residence. She lived in the home from 1973 until November 10, 2004.________

4. In January 2003, petitioner listed the home for sale and retained Kenneth M. Gammill, Esq., a Connecticut real estate attorney, to represent her in connection with the sale.

______5. In early September 2004, an offer to purchase was made by Daniel and Bonnie Tisch .[1] Thereafter, petitioner and Mr. Gammill commenced negotiations seeking to negotiate a sales contract free of any contingencies.

6. In Mr. Gammill's experience, many contracts associated with standard residential real estate transactions contained contingency clauses for mortgages and building inspections, but none was present in the contract between Ms. Michaels and the purchasers. In fact, in a letter from Mr. Gammill to petitioner, dated September 10, 2004, Mr. Gammill confirmed that the lack

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[1]Ultimately, only Bonnie Tisch purchased the premises as the sole purchaser and further reference to the "purchaser" will be the singular.

of contingencies was by design when he stated that "[t]he buyer's lawyer knows we expect an uncontingent contract on Monday . . . ."

7. On or about September 14, 2004, petitioner entered into a contract (the sales contract) to sell the home to Daniel and Bonnie Tisch for $14,000,000.00. Contemporaneously and pursuant to section 2 of the sales contract, a down payment of $1,400,000.00 was made, to be held in escrow, in consideration of which, and to provide collateral security for petitioner's obligations under the sales contract, petitioner executed a mortgage deed granting the premises to Daniel Tisch, but held in escrow by petitioner's attorney until such time that petitioner requested that the 10 percent down payment be released to her. In fact, the mortgage deed was forwarded to the purchasers' attorney, as referenced in a letter dated September 14, 2004, "in the event [petitioner] wishes the 10% payment released from escrow." Further, once all the covenants, agreements and provisions set forth in the mortgage deed were performed, the instrument became void, to be replaced by a warranty deed at closing.

8. In a rider to the sales contract, executed in October 2004, which included an additional 13 sections (23 through 35), it was provided that title would be taken only in the name of Bonnie J. Tisch.

9. On November 5, 2004, petitioner met with Mr. Gammill to sign what she believed to be all the necessary papers for the closing, i.e., all papers required of the seller at closing. She executed a power of attorney authorizing Mr. Gammill to appear on her behalf and to represent her at the closing.[2] Petitioner also signed and dated a warranty deed[3] for the premises and

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[2] Section 27 of the rider authorized petitioner, in the event that she was unable to attend the closing, to "execute and deliver to Purchaser a letter authorizing Purchaser to make the proceeds of sale due at the closing payable to the order of Seller's attorney, as trustee . . . ." A copy of the authorizing letter is contained in the record.

[3] No warranty deed was submitted into evidence by either party.

executed a seller's affidavit stating that there were no impediments to clear title as required by the purchaser's title insurance company in order to issue title insurance. She also signed a letter to the purchaser authorizing her to make all payments to petitioner's attorneys or parties she designated.

10. The sales contract set forth a closing date of November 8, 2004 and contained a provision (section 17) allowing this date to be extended by a period not in excess of three weeks without either party being deemed in default. The provision also addressed the purchaser's liability for delaying the closing, providing, in pertinent part:

> [i]n the event of a delay in the closing as set forth herein for more than 5 business days, . . . through no fault of the Seller, the Purchaser will reimburse the Seller from the sixth (6th) business day to the date of actual closing of title for the Seller's carrying costs of said property, including taxes, mortgage interest, utilities and per diem interest on Seller's equity in the premises . . . .

In fact, an adjustment for the purchaser's delay was assessed at the closing and accounted for in the closing statement.

11. The sales contract contained 22 numbered sections, each preceded by an identifying caption, a schedule A and a schedule B. The rider contained an additional 13 sections. Sections with particular relevance herein are, as follows:

a. Section 2, entitled "**CONSIDERATION**," set forth the purchase price of $14,000,000.00, to be paid by the purchaser as follows: $1,400,000.00 on or before execution of the sales contract and the remaining $12,600,000.00 "[u]pon delivery of the deed hereunder, by certified check or cashier's check . . . ."

b. Section 3, entitled "**DEED**," in pertinent part, stated that, upon full payment in the manner prescribed, petitioner would execute, acknowledge and deliver a Connecticut warranty

deed to the purchaser free of all encumbrances. Further, petitioner was bound to pay any real estate conveyance taxes and deliver all conveyance tax forms to the purchaser.

c. Section 4, entitled "**TITLE**," provided that if, upon delivery of the deed, petitioner was unable to convey title, petitioner would be allowed up to 30 days to perfect title. If petitioner failed to do so, the purchaser could "elect to accept such title as the Seller can convey, without modification of the purchase price, or may reject such title."

d. Under section 10, entitled "**RISK OF LOSS**," petitioner assumed "[t]he risk of loss by fire or other casualty to the buildings on said premises until the time of the delivery of the deed." In the event that such fire or casualty occurred, petitioner would have been provided 30 days to "repair or replace such loss or damage" or, in the event that petitioner failed to do so, the purchaser would be given the option of terminating the agreement or accepting the deed upon payment of the purchase price and receiving the benefit of all insurance moneys recovered, less actual expenditures on repairs.

e. Section 11, entitled "**AFFIDAVITS**," required petitioner to furnish an affidavit at the time of closing verifying the nonexistence of certain liens, rights and claims with respect to both the premises and fixtures.

f. Section 18, entitled "**MORTGAGE CONTINGENCY**," stated only that the section had been "[i]ntentionally omitted."

g. Section 28 of the rider provided, in part:

> [i]f Purchaser is in default hereunder and Seller stands ready to perform Seller's obligations, Seller's sole remedy shall be the right to terminate this Agreement by written notice to Purchaser or Purchaser's attorney and retain the down payment as reasonable liquidated damages for Purchaser's inability or unwillingness to perform.

h. Section 6 in the Rider to the Agreement provided that petitioner would cooperate in allowing entry onto the property, with reasonable notice, for the purchaser to take dimensions and have an appraisal done.

12. On November 9, 2004, petitioner closed on the purchase of a condominium in New York City and immediately began residing there, terminating her use of the Connecticut home as a residence.

13. On November 29, 2004, petitioner closed on the sale of the Connecticut home. As petitioner did not attend the closing, the purchaser provided a check to Mr. Gammill, dated November 29, 2004, in the amount of $12,621,109.38 in satisfaction of the balance due. In accordance with the "Financial Statement Of Closing" prepared by Mr. Gammill's firm, this amount represented the contracted purchase price of $14,000,000.00, with the following adjustments:

a. a credit to petitioner for prepaid taxes ($5,544.00);

b. a credit to petitioner for "[r]eimbursement due to closing delay" ($15,565.38);

c. a credit to the purchaser for the 10% down payment ($1,400,000.00).

14. For the year 2004, petitioner filed personal income tax returns as a part-year resident of Connecticut from January 1 through November 9, as a part-year resident of New York State and City from November 10 through December 31, and as a nonresident of California.

15. Petitioner's 2004 federal income tax return schedule of capital gains and losses (Schedule D) listed, inter alia, a capital gain of $11,611,424.00 for an item denoted "SALE OF YOUR HOME," listing an acquisition date of "01/01/84" and a sale date of "11/29/04."

16. Petitioner's 2004 Schedule of Income From Connecticut Sources (Schedule CT-SI), an attachment to her 2004 Connecticut income tax return, listed capital gains of $11,465,821.00

and income from Connecticut sources of $11,537,662.00, resulting in Connecticut income tax of $576,659.00. The capital gains listed thereon included petitioner's gain from the sale of the Connecticut home, which she treated as accruing during her Connecticut resident period.

______17. Petitioner's 2004 New York State Nonresident and Part-Year Resident Income Tax Return (Form IT-203) listed federal capital gains of $11,483,022.00 and New York capital gain of $17,201.00. New York adjusted gross income amounted to $32,755.00 and New York State and City income tax due of $4,444.00.

18. Petitioner's 2004 California nonresident income tax return (Form 540NR) lists California adjusted gross income of $1,392.00, taxable income of $1,391.00 and total California tax due of $129.00.

19. In May 2007, the Division of Taxation (Division) commenced a personal income tax audit of petitioner for the year 2004. The Division requested certain items of information be submitted by petitioner for examination, including the sales contract.

20. After reviewing the information provided, including the sales contract, the auditor determined that petitioner had changed her domicile from Connecticut to New York City on November 10, 2004 and that her gain from the sale of the Connecticut property accrued to November 29, 2004, the date on which the sale closed, i.e., during petitioner's resident period. Specifically, the audit report states:

> [t]here were causes [*sic*] in the sales agreement that could cause the sale to be cancelled. A) Section 10 lets the Purchaser to [*sic*] terminate the sales contract if the property was damaged by fire or something else & not repaired within 30 days. B) Section 28 allowed the Purchaser to terminate the agreement if the taxpayer was in default of the agreement. C) There can also be some other reasons for the closing not take place [*sic*]. Therefore, it is our position that the gain on the sales [*sic*] of the property was not fixed and determinable until the actual closing date on 11/29/2004. It is our position that the income was not accrued to taxpayer until the actual closing date.

21. On or about October 24, 2007, a statement of audit change was sent to petitioner's representative, after which the Division was informed that petitioner disagreed with the Division's findings. Accordingly, the case was closed as disagreed with no payment.

22. On December 27, 2007, the Division issued to petitioner a Notice of Deficiency (Assessment No. L-029537959) for the year 2004 asserting additional tax due of $811,735.00, plus interest of $206,005.10 and penalty of $144,343.54, for a total amount due of $1,162,083.64.

SUMMARY OF THE PARTIES' POSITIONS

23. Petitioner contends that she properly accrued to her nonresident period the gain from the sale of the Connecticut property, specifically, that the gain should accrue to September 14, 2004, the day on which the sales contract was executed. Petitioner believes that her fixed right to receive the sales proceeds vested on that date, and for purposes of the accrual test created by Tax Law § 639(b), a completed sale occurred on execution.

In response to the auditor's finding that the existence of contingencies in the sales contract prevented the accrual of gain until the transfer of title, petitioner argues that the contingencies noted by the Division were either conditions subsequent or ministerial acts that do not bar the accrual of income to the nonresident period. Petitioner further asserts that penalties are not warranted in this matter because she accrued the income to her Connecticut resident period based on a prudent and reasonable interpretation of the Tax Law, regulations and other guidance.

24. The Division argues that petitioner improperly accrued the gain from the sale of the Connecticut property to her nonresident period due to the existence of five contingencies in the

sales contract that precluded petitioner from having a fixed right to the income until the actual date of closing when the purchaser first assumed the burdens and the benefits of ownership.

CONCLUSIONS OF LAW

A. When an individual changes his or her status from nonresident to resident, Tax Law § 639(b) requires that the individual

> accrue to the period of nonresidence any items of income, gain, loss or deduction, . . . accruing prior to the change of status, with the applicable modifications and adjustments to federal adjusted gross income, itemized deductions and items of tax preference . . . other than items derived from or connected with New York sources . . . .[4]

Similarly, the regulations instruct that such individual must, "regardless of the method of accounting normally employed, accrue, for the portion of the year prior to such change, any items of income, gain, loss or deduction accruing prior to the change of resident status . . . " (20 NYCRR 154.10[e]). In addition, no "items of income, gain, loss or deduction, accrued under [Tax Law § 639] for the portion of the taxable year prior to a change of resident status, are to be taken into account in determining the New York adjusted gross income . . . or the New York taxable income . . . for any subsequent taxable period" (20 NYCRR 154.10[f]; ***see also*** Tax Law § 639[c]).

B. The regulations specifically address the treatment of capital gains when an individual changes resident status during a taxable year. In particular,

> the net capital gains . . . are to be computed separately for the resident period and for the nonresident period covered by the New York State income tax returns required under this Part. In each case, the computation of the capital gain . . . to be reported is to be made in the same manner as the corresponding Federal computation and on the same basis as if the taxable year of such individual . . . for Federal income tax purposes were limited to the taxable period covered by the

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[4] ***See also*** New York City Administrative Code § 11-1754(c)(2) for parallel provisions respecting individuals changing their status from a City nonresident to a City resident.

> applicable New York State income tax return, except that: (1) the separate computations applicable to the respective periods of residence and nonresidence must include any special accruals required by [20 NYCRR 154.10]; and (2) the capital gain . . . to be reported on the New York State nonresident income tax return for the period of nonresidence includes only those capital gains . . . reported for Federal income tax purposes which are derived from or connected with New York State sources during the nonresident period . . . (20 NYCRR 154.7[a]).

C. Tax Law § 639 and the regulations promulgated thereunder require conformity with the relevant provisions of the Internal Revenue Code (IRC) to determine the proper accrual of items of income (***see*** Tax Law § 607[a]; ***Matter of Brenhouse***, Tax Appeals Tribunal, September 4, 2008 ["the Tax Law commands conformity with Federal law in the application of the personal income tax"]). Therefore, the inquiry in this matter turns to the IRC to determine proper accrual of the income here at issue. Moreover, in the absence of New York case law, it is proper to look to federal interpretations of similar Internal Revenue Code provisions (***see Matter of Yellin v. New York State Tax Commn.***, 81 AD2d 196 [1981] ["New York income tax law evinces a strong intent to conform to Federal authority wherever possible . . . "]).

D. Section 451(a) of the IRC sets forth the general requirement that items of income be recognized in the period of receipt, unless the item is properly accounted for in a different period in accordance with the taxpayer's method of accounting. This general rule for income recognition describes the cash method, under which "an amount is includible in gross income when actually or constructively received" (Treas Reg § 1.451-1[a]). In contrast, under the accrual method, an item must be included in gross income "when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy . . . " (***id.; see Matter of Blanc***, Tax Appeals Tribunal, April 16, 2000, ***confirmed*** 282 AD2d 896 [2001]). This rule is often referred to as the "all events test."

The IRC indicates that gross income within the meaning of IRC § 61(a) does not arise until property is considered sold or otherwise disposed of for federal tax purposes (IRC § 1001[a]; § 61[a][3]). The question presented is whether the sale of petitioner's Connecticut home was a closed and completed sale prior to her change of residence. The courts have consistently held that, for tax purposes, the transfer of ownership is completed upon the passage of title or the passage of the benefits and burdens of ownership, whichever occurs first (***Dettmers v. Commissioner***, 430 F2d 1019 [6th Cir 1970]). The time of passage of title and the legal rights thereby created are determined by State law (***Fletcher v. United States***, 436 F2d 413 [7th Cir 1971]). In New York, a grant of real property takes effect only from the delivery of a valid deed by the grantor to the grantee (Real Property Tax Law § 244; ***Deepwells Estates Inc. v. Incorporated Village of Head of Harbor***, 973 F Supp 338, 345 [1999], ***appeal dismissed*** 162 F3d 1147 [1997]).

The ***Dettmers*** test is a reaffirmation of a longstanding principle:

> A closed transaction for tax purposes results from a contract of sale which is absolute and unconditional on the part of the seller to deliver to the buyer a deed upon payment of the consideration and by which the purchaser secures immediate possession and exercises all the rights of ownership. (***Commissioner v. Union Pacific Railroad Co.***, 86 F2d 637 [2d Cir 1936]).

The question of when a sale is complete for tax purposes is essentially one of fact that must be resolved by an examination of all the facts and circumstances, no single one of which is controlling. (***Baird v. Commissioner***, 68 TC 115, 124 [1977].)

Here, even assuming that all the conditions and contingencies set out in the sales contract had been met or satisfied by the seller as of November 5, 2004, the date she met with her attorney to execute the deed, there was no completed sale for tax purposes under the principles set forth above. While it is true that transfer of legal title is not a prerequisite for a completed sale (***Keith***

v. Commr., 115 TC 605, 611 [2000]), instances where a completed sale have been found without such transfer have demonstrated that the benefits and burdens of ownership did pass to the purchaser, creating at least the color of an equitable claim to title.

In ***Baird***, equitable title and the benefits and burdens of ownership were found to have passed prior to the execution of the deed where the purchaser had assumed liability for preexisting mortgages and other responsibilities for the construction of a convalescent home. In ***Keith***, the buyers were granted possession of the property during the term of the sales contract and were required to pay property taxes, insurance, and maintenance, thus enabling the court to find that the benefits and burdens of ownership had passed on execution of the sales contract and created a completed sale for tax purposes, and all income attributable to such disposition was recognized for that taxable year. In ***Merrill v. Commissioner*** (40 TC 66 [1963], ***affd*** 336 F2d 771 [9th Cir 1964]), the court found a completed sale for tax purposes before actual transfer of title based upon the purchasers' assumption of almost all the beneficial and detrimental incidents of ownership subject only to their tender of the remainder of the purchase price. **(*See also* *Bradford v. U.S.***, 444 F2d 1133 [Ct Cl 1971] [where a buyer was unconditionally obligated to perform and acquired the benefits and burdens of ownership where substantial performance of conditions precedent occurred and the only unfulfilled promise under the contract was payment of purchase price]).

In the circumstances at hand, the purchaser obtained no legal interest in the property and assumed none of the benefits and burdens of ownership, even needing prior permission to enter the premises prior to closing for purposes of taking measurements. All risk of loss remained with petitioner until transfer of title as provided in section 10 of the sales contract. Without the

assumption of the burdens and benefits of ownership, it is impossible to find that a completed transaction for tax purposes occurred before transfer of title. (***See Dettmers*** at 124.*)*

This is so even though petitioner executed a mortgage deed, which was to be held in escrow pending petitioner's full performance under the sales contract. This mortgage deed was merely security for the substantial deposit paid by purchaser. By its own terms, the mortgage deed became null and void upon performance of the covenants, agreements and provisions contained in both the mortgage deed and the sales contract, which would only occur at closing when full payment was made on delivery of the deed to purchaser.

E. Petitioner raises the possibility in her reply brief that section 17 of the contract may have conveyed some of the necessary benefits and burdens of ownership in that it required the purchaser to reimburse petitioner to the date of actual closing for petitioner's carrying costs of the property, including taxes, mortgage interest, utilities and the per diem interest on petitioner's equity in the premises. However, the clause only took effect if the original closing date were delayed for more than five business days. So the assumption of any carrying costs would not have been operative until September 13, 2004, at the earliest, and after petitioner had changed her residence to New York. Therefore, the argument that the purchaser obtained equitable title or assumed the benefits or burdens of ownership before the date petitioner acquired her New York residence must fail.

F. Both parties addressed ***Matter of Frey*** (State Tax Commission, April 9, 1982 [where it was decided that taxpayers must, regardless of the method of accounting they usually employ, accrue and include all items as if they were filing a federal return for each period of nonresidency

and residency on the accrual basis]).[5] However, the analysis in that decision was not complete and no conclusions were made concerning the issue of accrual as applied to the facts, which appear closely akin to those in issue. The Commission's decision was based on petitioner's failure to submit the requisite evidence to support its petition and therefore failed to meet its burden of proof.

Likewise, petitioner's argument that the example set forth in the Division's regulations at 20 NYCRR 154.10(d) is controlling of the instant facts is in error. In that example, Taxpayer A contracted to sell New York property (not his home) on September 1, 1985 subject to the purchaser investigating title and procuring a mortgage. Taxpayer A moved out of state on September 10, 1985, while the closing on his New York property took place on October 20, 1985. The example concluded that the gain was not accruable to Taxpayer A's period of residence in 1985 because of the conditions in the sales contract.

To the extent the example holds that the gain from the sale of the New York real property did not accrue to the period of New York residency because of contingencies in the sales contract, it is not substantiated by the language of the regulation.

The regulation at 20 NYCRR 154.10(e), pertinent to where a nonresident becomes a resident, only states that regardless of the method of accounting normally employed, the individual who changes from nonresident to resident must accrue, for the portion of the year prior to such change, any items of income, gain, loss or deduction accruing prior to the change of resident status. To the extent that the example following 20 NYCRR 154.10(d) is not consistent with the analysis above, and the facts disclosed in the example do not necessarily so indicate, it is

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[5]As decisions of a body of coordinate jurisdiction, the State Tax Commission decisions are not binding precedent, but are entitled to respectful consideration (***see Matter of Cruikshank's Estate***, 169 Misc 514, 8 NYS2d 279 [1938]; ***Matter of Racal Corporation***, Tax Appeals Tribunal, May 13, 1993).

rejected and will not be considered or relied upon for guidance herein.[6]

G. Where a person fails to timely pay any taxes due or fails to meet or fulfill any other requirement of the Tax Law, the applicable penalties must be imposed unless it is shown that the failure was due to reasonable cause and not wilfull neglect (20 NYCRR 2392.1[a][1]). Here, petitioner believed she had reported the gain from the sale of the Connecticut property properly in accruing the gain to her period of nonresidence based on the law, regulations and available guidance.

It is determined that reasonable cause exists for waiver of penalties in this matter. Petitioner's reliance on an interpretation of the statute and regulations as applied to her circumstances, while in error, can be said to appear to a person of ordinary prudence and intelligence to be reasonable (20 NYCRR 2392.1[d][5]). This was not a case of ignorance of the law, but a case of first impression, and the facts here support the conclusion that petitioner's actions do not indicate willful neglect of her tax responsibilities. There was no New York case precedent or proper guidance in the law or regulations. The ***Frey*** matter, although similar to the facts of this matter, was inconclusive and the example in the regulations at 20 NYCRR 154.10(d), to the extent analogous to the instant matter, has been rejected for the reasons stated above. Thus, the confusion raised by these sources must be construed most favorably for petitioner.

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[6]Section 154.10 was added to the Income Tax Regulations on January 13, 1992 and effective January 29, 1992 – approximately two years before Tax Law § 639 was initially enacted in chapter 170 of the Laws of 1994. The events described in the example, occurring in 1985, also predate the enactment of Tax Law § 639. As such, it is unclear if the facts of the example would reach the same result under section 639, as added in 1994 and subsequently amended in 2004, if they instead occurred after section 639 was enacted. It is also noted that the example closely resembles the ***Frey*** decision, which was issued in 1982, and may have extrapolated its conclusion based on ***Frey***.

H. The petition of Glenna Michaels is granted to the extent set forth in Conclusion of Law G, but in all other respects is denied and the Notice of Deficiency dated December 27, 2007 is sustained.

Dated: Albany, New York
April 12, 2012

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