STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
NORMA BAGDAN	:	DETERMINATION DTA NO. 819260
for Redetermination of a Deficiency or for Refund of Gift Tax under Article 26-A of the Tax Law for the Year 1998.	: :	

Petitioner, Norma Bagdan, 17 Consaul Road, Amsterdam, New York 12010, filed a petition for redetermination of a deficiency or for refund of gift tax under Article 26-A of the Tax Law for the year 1998.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on July 29, 2003 at 10:00 A.M., with all briefs to be submitted by November 20, 2003, which date began the six-month period for the issuance of this determination. Petitioner appeared by John W. Sutton, Esq. The Division of Taxation appeared by Mark F. Volk, Esq. (Kevin R. Law, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly imposed gift tax upon a conveyance by petitioner of a parcel of real property or certain interests therein.

FINDINGS OF FACT

1. Prior to 1994, Norma Bagdan ("petitioner") was the sole owner of a certain parcel of real property located at 17 Consaul Road, Amsterdam, New York. Previously, the real property had been owned by petitioner and her husband, Joseph, who died on September 8, 1992. The

subject real property consists of a dairy farm of approximately 275 acres with certain farm structures (a dairy barn, three silos and storage buildings) and a two-story house.

2. After the death of her husband, it became the desire of petitioner to transfer the property, prior to her death, to her son, Robert, and daughter-in-law, Florence. Therefore, she sought the counsel of her attorney, John W. Sutton, Esq., to determine the best method to accomplish this transfer.

3. On December 13, 1994,[1] petitioner wrote and signed a letter to Robert J. Bagdan and Florence M. Bagdan, her son and daughter-in-law, which stated as follows:

> It is with great pleasure that I have decided to give you $20,000.00 as a gift. It is my decision to have the $20,000.00 take the form of a $20,000.00 interest in the farm property and as of today's date, you should consider yourself the owner of $20,000.00 worth of the farm. In order to have this gift shown in a legal manner, I have today signed a mortgage to your benefit in the amount of $20,000.00 with the mortgage covering the farm property.

On December 13, 1994, petitioner, as mortgagor, executed a note and mortgage to Robert J. Bagdan and Florence M. Bagdan, as mortgagees, in which she promised to pay to the mortgagees the sum of $20,000.00, with interest at the rate of 0%, in one lump-sum payment due April 1, 2000. The property mortgaged was the real property located at 17 Consaul Road, Amsterdam, New York.

4. On March 27, 1995, November 25, 1996 and January 24, 1997, petitioner wrote similar letters to her son and daughter-in-law each of which informed them that she was giving them an additional $20,000.00 as a gift which was to take the form of an interest in the farm property. The letters informed her son and daughter-in-law that they now owned $40,000.00, $60,000.00

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[1] At the hearing held in this matter, the Division of Taxation stipulated that for each of the dated documents introduced into evidence by petitioner, such document was signed on the date indicated thereon.

and $80,000.00 worth of the farm, respectively. Each letter also stated that petitioner had signed a mortgage to their benefit in the amount of $20,000.00 with such mortgage covering the farm property.

Petitioner did, in fact, execute a mortgage simultaneously with each of the aforesaid letters in the amount of $20,000.00. As was the case with the first mortgage of December 13, 1994, petitioner, as mortgagor, was obligated to pay the sum of $20,000.00, at an interest rate of 0%, in one lump sum on or before April 1, 2000.

5. On February 18, 1998, petitioner once again wrote a letter to her son and daughter-in-law informing them that she was giving them another $20,000.00 interest in the farm. This letter also stated as follows:

> I have also authorized Mr. Sutton to file a deed to the property in your name with the understanding that I continue to own the value of the farm above $100,000. The remainder interest may be as high as $350,000 if the Barnoski appraisal[2] is accurate. As we have discussed, the appraisal of the property continues to seem quite high.
>
> At this time, you own $100,000 worth of the real property and I own the remainder.

No mortgage was executed in 1998. However, on the same date as the letter, i.e., February 18, 1998, Robert J. Bagdan and Florence M. Bagdan executed four satisfactions of mortgage whereby they discharged each of the four $20,000.00 mortgages dated December 13, 1994, March 25, 1995, November 25, 1996 and January 24, 1997.

Also on February 18, 1998, petitioner executed a deed of the subject real property to Robert J. Bagdan and Florence M. Bagdan, his wife. This deed was recorded in the Saratoga

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[2] An appraisal of petitioner's property as of March 3, 1995 was prepared by Sacandaga Appraisal Service of Amsterdam, New York (Henry Barnoski, Appraiser) which concluded that the fair market value of the property was $475,000.00.

County Clerk's Office on March 18, 1998 in Book 1484 of Deeds at page 202. The deed did not indicate thereon that the conveyance was of only a portion of the property or a percentage interest or that petitioner (the grantor) was reserving an interest in the property.

6. On November 20, 2000, petitioner wrote a letter to her son and daughter-in-law which stated as follows:

> I take great pleasure in completing my gift of the farm to you two today. I hereby give you the remaining equity which I own in the farm which may be as much as $350,000.00 depending on whether the Barnoski appraisal was accurate.
>
> You now own the farm entirely.

7. By letter dated February 28, 2000, the Division of Taxation ("Division") notified petitioner that it had received information that she had made a transfer of real property to Robert and Florence Bagdan on February 18, 1998. The letter advised petitioner that a transfer of property in which the transferor does not receive money for the transfer or receives less than the full fair market value of the property is a gift which could be taxable pursuant to Article 26-A of the Tax Law. The Division's letter informed petitioner that if she felt that the transfer was not a gift, she should respond with an explanation.

8. On behalf of petitioner, her representative, John W. Sutton, Esq., responded to the Division's inquiry with a letter dated March 16, 2000 which stated that no reportable gift occurred at the time of the execution and recordation of the deed. The letter explained as follows:

> Commencing in 1994, Mrs. Bagdan has executed gift letters to her son and daughter in law giving Twenty Thousand Dollars annually in equity in the farm property where all the Bagdans live and work. The gifting plan of the Bagdan family was and is to give the exemption amount of gifting [sic] in farm equity annually until such time as the remaining equity in the farm could be given without gift tax liability. Each gift letter was supported by a mortgage lien on the property in favor of the donees.

* * *

> Mrs. Bagdan has continued to own a fractional interest in the farm since 1998 when the deed was signed and recorded. At the end of 1999 (we failed to have any documents executed in 1999), Norma Bagdan continued to own the sum of Two Hundred Forty-Seven Thousand Dollars ($247,000.00) in equity of the farm with One Hundred Thousand Dollars having already been gifted over the course of the last five years. We have used the assessment of the property to compute the value.
>
> It is our intent to complete the gift this year with the remainder of the farm equity held by Mrs. Bagdan being gifted.
>
> I went forward and recorded the deed in contemplation of the considerable ownership of farm equity by Mr. and Mrs. Robert Bagdan in 1998. Just as the deed recorded prior to 1998 did not prevent Mrs. Bagdan from giving fractional interests in the real estate to her son and daughter in law, the present recorded deed does not prevent Mrs. Bagdan from retaining fractional ownership. This situation is well supported by the mutual possession of the realty by the parties.

9. On November 13, 2000, the Division responded to Mr. Sutton's letter by requesting additional information.[3] In addition, the Division's letter advised of Revenue Ruling 77-299, 1977-2 CB 343, which, according to the Division, "states that the transfer of real property, secured by a purchase money mortgage which is equal in amount to the annual exclusion and to be forgiven annually is not a bona fide sale made at arm's length between the parties but was a transfer of the real estate subject to gift tax."

10. By letter dated November 20, 2000, the requested documentation was supplied by Mr. Sutton. This letter, in relevant part, stated that:

> the gifts given by Mrs. Bagdan in the form of equity of the realty was shown by mortgages from Mrs. Bagdan to her son and daughter in law. Successive conveyances showing different percentages of ownership between [sic] the three parties seemed an inconvenient and expensive way to gift an annual slice of equity.

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[3] Apparently, Mr. Sutton had included just the 1994 gift letter and mortgage with his March 16, 2000 letter. The Division, therefore, requested copies of the 1995 through 1998 gift letters and mortgages.

* * *

> We have delayed in completing the gift this year to ascertain your office's intent in this matter. We have now chosen to gift the entire remaining equity in the farm from Mrs. Bagdan to her son and daughter in law and have now accomplished the same.

* * *

> I further send herewith discharge documents which I had the Bagdan's [sic] sign for each mortgage on February 18, 1998. These documents were not filled in because the original mortgages were not recorded and the discharges did not really have to be used. However, the act of the son and daughter in law on that day was to discharge the mortgages in that the deed to the property was going to them.

11. The Division, on December 7, 2000, notified petitioner's representative that it was unable to accept the notifications to Mrs. Bagdan's children of their annual gifts for the years 1995 to 1998 since they were not notarized on the date of the gift. Since the mortgage notes were all notarized on February 18, 1998, it was the Division's position that an $80,000.00 mortgage was initiated on that date. Therefore, the Division advised that a reportable gift of the market value occurred and a return was required to be filed (a blank gift tax return was enclosed).

12. On May 14, 2001, a Notice of Estimated Deficiency was issued to petitioner by the Division which asserted an estimated gift tax deficiency in the amount of $9,500.00, plus interest of $1,598.80 and penalty of $2,375.00, for a total amount due of $13,473.80 for the year 1998. This notice advised petitioner that the Division's records indicated that she had not filed the required tax returns and that estimated liability would be canceled if she filed the returns due and paid the actual tax due plus appropriate penalty and interest by August 12, 2001.

13. On June 4, 2001, a New York State Gift Tax Return for the year 1998 was sent to the Division which reported gross gifts of $20,000.00 ($10,000.00 gifts of equity in the Consaul road

farm to each of Robert J. Bagdan and Florence M. Bagdan). Since the New York annual exclusion was $20,000.00, New York taxable gifts were reported to be $0.

14. The Division's letter of June 7, 2001 advised Mr. Sutton that it could not accept the return as filed on June 4, 2001.

15. By letter dated June 11, 2001, Mr. Sutton, noting that he had never received the Division's letter of December 7, 2000 (in which the Division asserted that all of the mortgages were notarized on February 18, 1998 and, therefore, that an $80,000.00 mortgage was initiated on that date), correctly pointed out that it was the mortgage satisfactions, not the mortgages, which were notarized in 1998. Mr. Sutton then stated that since this was the only objection lodged by the Division, it was his hope that the return would now be accepted and the matter would be closed. A copy of the recorded deed was attached to the letter.

16. On July 10, 2001, the Division's response to Mr. Sutton's June 11, 2001 letter explained as follows:

> The point I was trying to make was that **all the proposed mortgage payments were forgiven on the same date.** To stay under the annual exclusion, Mrs. Bagdan could only forgive $10,000.00 per year per donee.
>
> On February 18, 1998, principal sums in the amount of $20,000.00 were forgiven for the years 1994, 1995, 1996 and 1997. This means that Mrs. Bagdan **forgave** debt in the amount of $80,000.00 in 1998 well above the annual exclusion allowed of $20,000.00 for two donees for the tax year 1998.
>
> We cannot accept the notes giving the $20,000.00 gifts as they were not notarized memorializing the intent of the gift in the year it was given.
>
> Review of the deed recorded on February 18, 1998 does not reveal that a partial interest was transferred on that date. Therefore, we would assume that 100% was transferred.

17. Petitioner filed a request for a conciliation conference with the Division's Bureau of Conciliation and Mediation Services. A conciliation conference was held on December 12, 2001

and a Conciliation Order (CMS No. 187975) was issued on September 27, 2002 which denied petitioner's request and sustained the statutory notice.

On December 20, 2002, petitioner filed a petition seeking administrative review with the Division of Tax Appeals. The Division, in paragraph "8" of its answer to the petition, affirmatively stated that the Notice of Estimated Deficiency which originally asserted tax due of $9,500.00 plus penalties and interest was increased to assert tax due of $17,250.00 plus interest based upon the appraisal submitted by petitioner.[4] Penalties were no longer being asserted by the Division.

SUMMARY OF THE PARTIES' POSITIONS

18. Petitioner contends:

a. The writings of petitioner effected a gift of a fixed dollar amount of equity in the farm as well as a reservation of interest by petitioner;

b. The execution of the deed did not frustrate the parties' intent that petitioner reserved an equity interest in the property; and

c. Revenue Ruling 77-299, 1977-2 CB 343, cited by the Division in its letter of November 13, 2000 (***see***, Finding of fact "9") is irrelevant to this proceeding.

19. The Division's response is as follows:

a. Nothing in the deed from petitioner to her son and daughter-in-law on February 18, 1998 indicates any prior transfers of portions of the property;

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[4] The Division's assertion of a greater deficiency was based upon a letter sent by the Division to petitioner which contained the following: "Based on the deed submitted, a 100% [sic] of the property was conveyed by Norma Bagdan to Robert and Florence Bagdan on February 18, 1998. The market value used for transfer was based on the March 3, 1995 appraisal ($475,000). Two annual exclusions were allowed. The assessment is correct as previously adjusted."

b. The deed effectuated a complete transfer of the property on February 18, 1998 and there was no indication in the deed that petitioner had retained an interest in the property; and

c. The testimony of petitioner and her son that she gifted dollar value interests in the farm to her son and daughter-in-law commencing in 1994 cannot be used to contradict the terms of the deed executed in 1998.

CONCLUSIONS OF LAW

A. Tax Law former § 1003,[5] in effect during the period at issue, provided that the New York gifts of a New York resident were the total amount of gifts made in any calendar year within the meaning of Internal Revenue Code ("IRC") § 2503.

IRC § 2503(b) stated that in the case of gifts made to any person by a donor during a calendar year, the first $10,000.00 of such gifts to such person shall not be included in the total amount of gifts made during the year.

It is petitioner's position that for each calendar year commencing in 1994, she gave a series of gifts of equity in her real property to her son and daughter-in-law (Robert J. Bagdan and Florence M. Bagdan) with the amount of such annual gift being $10,000.00 each to her son and daughter-in-law, thereby qualifying for the annual gift tax exclusion as provided by IRC § 2503(b) which, accordingly, would have rendered each such gift exempt from the New York State gift tax pursuant to Tax Law former § 1003.

B. As previously noted, petitioner attempted to make these annual gifts by means of gift letters dated December 13, 1994, March 27, 1995, November 25, 1996, January 24, 1997 and February 18, 1998. For each of the years 1994 through 1997, petitioner also executed a

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[5] Tax Law § 1003 was repealed by chapter 389 of the Laws of 1997, effective January 1, 2000.

mortgage in the amount of $20,000.00 to her son and daughter-in-law simultaneously with each of the gift letters. In 1998, no mortgage was executed. However, on February 18, 1998, petitioner's son and daughter-in-law executed four satisfactions of mortgage discharging each of the four $20,000.00 mortgages executed by petitioner in 1994, 1995, 1996 and 1997, and on the same date, petitioner deeded the subject property to her son and daughter-in-law.

C. Real Property Law § 240(2) provides that the term "conveyance" "includes every instrument, in writing, except a will, by which any estate or interest in real property is created, transferred, assigned or surrendered.

D. In New York, a mortgage merely creates a lien rather than a conveyance of title (***Bean v. Walker***, 95 AD2d 70, 464 NYS2d 895).

E. Transfer of title to real property is accomplished only by the delivery and acceptance of an executed deed (***In re Cahill***, 264 AD2d 480, 694 NYS2d 153; ***McLoughlin v. McLoughlin***, 237 AD2d 336, 654 NYS2d 407).

F. As pointed out by the Tax Appeals Tribunal in ***Matter of Delese*** (Tax Appeals Tribunal, August 8, 2002, ***confirmed*** 3 AD3d 612, 771 NYS2d 191), it is proper to look to pertinent Federal statutes and regulations to interpret those sections of the Tax Law pertaining to the gift tax since the New York gift tax is inextricably linked with the Federal law. Tax Law § 1004(e) specifically cites to sections of the Internal Revenue Code which pertain to the computation of New York gifts, New York taxable gifts and the tax under Article 26-A of the Tax Law.

G. A taxable gift requires the *transfer* of property, a property right or an interest in property (IRC § 2501[a]). The tax is imposed upon the donor's act of making the transfer (Treas Reg § 25.2511-2[a]). If the property to be given is such that physical delivery is not possible

(such as a parcel of real property), then delivery of a deed makes the transfer complete (***see***, ***Macomber v. Commissioner***, 10 TCM 539).

In a case in which a father executed deeds conveying property to his children eight years after entering into contracts to sell the property to them, the IRS ruled that the transfer was not complete until the deeds were executed since it was not until such time as the deeds were executed that the father relinquished dominion and control over the property (IRS Letter Ruling 9513001).

As noted by the IRS in a pertinent regulation:

> As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. (Treas Reg § 25.2511-2[b].)

H. In the present matter, while petitioner wrote letters to her son and daughter-in-law which purported to give them a $20,000.00 interest in her farm property for each of the years 1994 through 1997, no deed was issued during any of these years which transferred such $20,000.00 interest. Since no deed was executed which memorialized these purported $20,000.00 gifts of equity in the property, no transfer of title or any portion thereof was accomplished until February 18, 1998, the date on which petitioner conveyed, by deed, the farm property to her son and daughter-in-law. Clearly, at any time up to the date on which she executed this deed of the property, petitioner had dominion and control over the property and had the right (although not exercised) to modify or revoke the letters in which she previously

expressed her desire to give each of the $20,000.00 interests in the property. Therefore, it must be found that no gifts were made by petitioner in 1994, 1995, 1996 or 1997.

I. In 1998, on February 18th thereof, petitioner executed a deed of her farm property to her son and daughter-in-law. Despite the assertion by petitioner in a letter to her son and daughter-in-law (written on the same date as the execution of the deed) that she was giving them another $20,000.00 interest in the farm and was reserving a "remainder interest" which "may be as high as $350,000 if the Barnoski appraisal is accurate," an examination of the deed reveals no such reservation. Nowhere on the deed is there any indication that the conveyance was of anything less than the entire parcel of real property. As correctly noted by the Division in its letter brief of October 22, 2003, "[g]enerally, the interests obtained from the deed are construed in accordance with the language contained in the instrument and parol proof is inadmissible to vary or contradict its terms." (***Prario v. Novo***, 168 Misc 2d 610, 645 NYS2d 269, 271.) Accordingly, despite the testimony of both petitioner and her son, at the hearing held in this matter, that she attempted to give a $20,000.00 interest in the farm to her son and daughter-in-law in each of the years 1994 through 1997, it must be found that the failure to execute a deed of such interests resulted in a failure of the intended gifts to properly vest and that the deed executed on February 18, 1998 was a deed of the entire parcel of property to her son and daughter-in-law with no remainder interest therein to petitioner.

Therefore, based upon the March 3, 1995 appraisal of the real property obtained by petitioner, it is hereby determined that petitioner made and completed (by executing and recording a deed) a gift in the sum of $475,000.00 to her son and daughter-in-law during the year 1998.

J. Pursuant to Tax Law § 689(e)(3), the burden of proof in any proceeding before the Division of Tax Appeals (***see***, Tax Law § 2026), is on the petitioner except in the case of an increase in a deficiency where the increase is asserted initially after the notice of deficiency was mailed and a petition was filed wherein the burden of proof shall be upon the Division of Taxation. Based upon the foregoing, it is hereby determined that the Division has met its burden of proving that the increase in the deficiency was warranted in this matter. Accordingly, it was proper for the Division to assert a deficiency of gift tax in the amount of $17,500.00 (***see***, Finding of Fact "17"), plus interest, for the year 1998.

K. By virtue of the foregoing, it is hereby determined that Revenue Ruling 77-299, 1977-2 CB 343, which pertains to the forgiveness of certain nonnegotiable notes on an annual basis is not relevant to this matter.

L. The petition of Norma Bagdan is denied and the Notice of Estimated Deficiency issued May 14, 2001, as revised (***see***, Conclusions of Law "I" and "J"), is sustained.

DATED: Troy, New York
April 29, 2004

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE