STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
NORMA BAGDAN	:	DECISION 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 an exception to the determination of the Administrative Law Judge issued on April 29, 2004. Petitioner appeared by John W. Sutton, Esq. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Kevin R. Law, Esq., of counsel).

Petitioner filed a brief in support of her exception and the Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on November 17, 2004 in Troy, New York.

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

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

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

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.

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.

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

[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.

April 1, 2000. The property mortgaged was the real property located at 17 Consaul Road, Amsterdam, New York.

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 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.

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.

[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.

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 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.

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.

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.

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.

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,

[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.

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."

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.
>
> * * *
>
> 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.

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).

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.

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.

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

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.

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.

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.

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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."

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted that pursuant to Tax Law former § 1003, 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. The Administrative Law Judge observed that 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. The Administrative Law Judge pointed out that pursuant to IRC § 2503(b), the first $10,000.00 of gifts made to any person by a donor during a calendar year were not included in the total amount of gifts made during the year.

The Administrative Law Judge also observed the definition of a "conveyance" provided by Real Property Law § 240(2), which includes "every instrument, in writing, except a will, by which any estate or interest in real property is created, transferred, assigned or surrendered."

The Administrative Law Judge also noted applicable case law providing that, in New York, a mortgage merely creates a lien rather than conveys title.

The Administrative Law Judge found that 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. The Administrative Law Judge concluded that, as a result, there was no transfer of title or any portion thereof until February 18, 1998 when petitioner conveyed, by deed, the entire farm property to her son and daughter-in-law. The Administrative Law Judge observed that 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 to modify or revoke the gift letters.

Therefore, the Administrative Law Judge determined that petitioner made no gifts in 1994, 1995, 1996 or 1997.

The Administrative Law Judge found that on February 18, 1998, when petitioner executed a deed of her farm property to her son and daughter-in-law, the terms of the deed contradicted a contemporaneous letter by petitioner to her son and daughter-in-law which stated that she was giving them another $20,000.00 interest in the farm and was reserving a "remainder interest" for herself. The Administrative Law Judge found that the deed contained no indication that the conveyance was of anything less than the entire parcel of real property. The Administrative Law Judge held 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.

The Administrative Law Judge concluded that based upon the March 3, 1995 appraisal of the real property, 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. The Administrative Law Judge found that the Division met its burden of proving, pursuant to Tax Law § 689(e)(3), that the increase in the deficiency of gift tax asserted by the Division in its Answer, in the amount of $17,500.00, plus interest, for the year 1998 was warranted in this matter.

The Administrative Law Judge held that Revenue Ruling 77-299, 1977-2 CB 343, which pertains to the forgiveness of certain nonnegotiable notes on an annual basis was not relevant to this matter.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that contrary to the determination of the Administrative Law Judge, interests in real property may be transferred by means other than a deed, such as by will, adverse possession or, in the case of easements, by prescription or acquiescence. Petitioner asserts that in this case, the delivery of the gifts by petitioner was tailored to suit the circumstances of the case. Petitioner maintains that she gave her son and daughter-in-law gifts of equity in her property by a conveyance in writing subscribed by the grantor. Such a gift, posits petitioner, could not have been effected by executing a conventional deed.

Petitioner argues that the donor did not have dominion and control over the subject matter of her gifts once the gifts were given. Rather, the donees had an absolute right to contest any attempt by the donor to cancel her gifts. Petitioner maintains that her letter to her son and daughter-in-law reserving a remainder interest in the property was effective despite the fact that no such reservation was contained in the deed.

The Division, in opposition, argues that a deed was necessary in order for petitioner to make a gift of real property to her son and daughter-in-law. Such a deed was executed in February 1998 which conveyed the entire property to petitioner's donees without reservation of a life estate for herself. The Division maintains that petitioner's private communications to her son and daughter-in-law did not convey title to the real property to them.

OPINION

After reviewing the record in its entirety, we find that petitioner has offered no evidence below and no argument on exception which demonstrates that the Administrative Law Judge's determination is incorrect. While it appears that petitioner did make completed gifts to her son

and daughter-in-law in 1994, 1995, 1996 and 1997, these were not gifts of specified portions of petitioner's real property. Rather, they were gifts of promissory notes payable to the donees (***see***, Rev. Rul. 84-25, 1984-1 CB 191 [In the case of a legally enforceable promise for less than an adequate and full consideration in money or money's worth, the promisor makes a completed gift under section 2511 of the Internal Revenue Code on the date when the promise is binding and determinable in value rather than when the promised payment is actually made (citations omitted). . . In such a case, the amount of the gift is the fair market value of the contractual promise on the date it is binding (citations omitted)]; ***cf***, Rev. Rul. 67-396, 1967-2 CB 351 [The gift of the donor's own note is not complete until the note is paid or transferred for value]).

Petitioner's own actions belie her claim to have given interests in her property to her son and daughter-in-law. If she had, in fact, completed gifts of portions of her property to her son and daughter-in-law, she could not then have simultaneously mortgaged the same property to them as security for the notes she gifted to them. Rather, petitioner's son and daughter-in-law obtained, at best, a right to payment on successive notes secured by a mortgage interest in petitioner's property. The annual note and mortgage accompanying the "gift letters" did nothing to transmogrify these gift letters (***see***, ***Cohen v. Cohen*** 188 AD 933, 176 NYS 893) into a deed or other writing suitable to convey title.

In 1998, when petitioner conveyed fee title to her property to her son and daughter-in-law, there was no reservation by petitioner of a remainder interest. Rather, petitioner conveyed her entire interest in the property. Further, there was no indication in the deed that what petitioner was transferring had been in any way diminished by her 1994 through 1997 gifts. This was consistent with the fact that her prior gifts did not convey any of her interest in the ownership of

the property. The simultaneous discharge of petitioner's obligations on the outstanding notes by petitioner's son and daughter-in-law could be viewed as either a gift back by them to petitioner or consideration given by them for the real property interest they received. The record does not contain sufficient information to determine which. However, it is petitioner's burden to demonstrate the extent to which consideration was given for the interest in real property transferred and petitioner failed to demonstrate that the entire transfer in 1998 was not a gift.

As a result, we affirm the determination of the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Norma Bagdan is denied;

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

3. The petition of Norma Bagdan is denied; and

4. The Notice of Estimated Deficiency issued May 14, 2001, as modified in accordance with conclusions of law "I" and "J," is sustained.

DATED: Troy, New York
December 23, 2004

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner