

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>ANGELINA DELESE</b>	:	<b>DETERMINATION</b>
	:	<b>DTA NO. 817775</b>
	:	
for Revision of a Determination or for Refund of Gift Tax	:	
under Article 26-A of the Tax Law for the Year 1998.	:	

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Petitioner, Angelina Delese, 16 Preston Avenue, Staten Island, New York 10312, filed a petition for revision of a determination or for refund of gift tax under Article 26-A of the Tax Law for the year 1998.

On November 26, 2000 and December 1, 2000, respectively, petitioner, appearing by Walter W. Schnorbus, Esq., and the Division of Taxation, appearing by Barbara G. Billet, Esq. (Kevin R. Law, Esq., of counsel), consented to have the controversy determined on submission without a hearing. All briefs were due by April 20, 2001, which date commenced the six-month period to issue a determination in this matter.

Upon review of the entire record, Arthur S. Bray, Administrative Law Judge, renders the following determination.

***ISSUE***

Whether it was proper for the Division of Taxation to use a Treasury Regulation to interpret a provision of the Internal Revenue Code which had been incorporated into a New York statute without promulgating the Federal regulation.

***FINDINGS OF FACT***

The Division of Taxation (“Division”) and petitioner agreed to a Stipulation of Facts which has been incorporated into the following Findings of Fact. Additional Findings of Fact were also made.

1. On October 20, 1998, petitioner, Angelina Delese, transferred, by Bargain and Sale Deed with Covenants Against Grantor’s Acts, a house and real property located at 16 Preston Avenue, Staten Island, New York to Thomas Delese and Laura Delese, as tenants in common. The deed reserved a life estate in petitioner as grantor.

2. The house, located at 16 Preston Avenue, Staten Island, New York, was and remains petitioner’s primary residence.

3. In or about January 1999, petitioner filed a New York State Gift Tax Return. The return included an appraisal of the premises by Raymond A. Vomero Associates, Inc. which concluded that the market value of the real estate as of October 1, 1998 was \$185,000.00. When calculating the amount of gift tax due, petitioner subtracted the value of the remainder interest (i.e., the life estate).

4. Under Internal Revenue Code § 7520, 12.0% of the applicable Federal rate for determining the present value of a remainder for the month of October 1998 was 6.2%. Based on an interest rate of 6.2%, the remainder factor for grantor’s age of 70 was .49686 and the value of the remainder interest is \$91,919.00.

5. In a letter dated January 12, 2000, the Division advised petitioner that when the donor retains a life estate, New York State Tax Law employs the zero valuation rule in accordance with Internal Revenue Code § 2702. According to the letter, when real property is transferred by gift and the donor retains a life estate, the transaction is treated as a transfer in trust. Further,

pursuant to IRC § 2702 and sections 25.2702-1 and 25.2702-5 of the Treasury Regulations, the interest retained by the donor is to be valued at zero unless the property is transferred to a personal residence trust. Consequently, the Division determined that the corrected taxable gift was \$185,000.00 and that gift tax was due in the amount of \$4,900.00.

6. The Division issued a Notice of Deficiency, dated April 17, 2000, which asserted a deficiency of gift tax in the amount of \$4,900.00 plus interest in the amount of \$358.71 for a balance due of \$5,258.71.

7. Treasury Regulation § 25.2702-1 was in existence when the New York Legislature adopted IRC § 2702. The regulation became effective on January 28, 1992 while the Legislature incorporated IRC § 2702 on August 7, 1992.

8. Neither Treasury Regulation § 25.2702-1 nor § 25.2702-5 was promulgated by the Commissioner of Taxation and Finance using the procedure set forth in the State Administrative Procedure Act. The regulations were not filed with the Secretary of State.

9. Prior to October 1, 1997, the Division did not assess any transferor when the transferor retained a life estate, the transfer did not meet the requirements of Treasury Regulation § 25.2702-5, and the transferor subtracted the value of the retained interest in determining the value of the taxable gift.

10. On October 1, 1997, the Division determined that, when New York incorporated Internal Revenue Code §§ 2701 through 2704, the proper valuation method that should have been used was the zero valuation rules which are set forth in the corresponding Federal regulations. Approximately one year later, the change was publicized in an article which appeared in the New York Law Journal.

***SUMMARY OF THE PARTIES' POSITIONS***

11. Petitioner maintains that she is entitled to a refund because the Commissioner of Taxation and Finance did not promulgate Treasury Regulation § 25.2702-5 pursuant to the procedures found in the Administrative Procedure Act, the Executive Law and the New York State Constitution. As corollaries to this position, petitioner submits: that there is case authority that the Commissioner's policy of applying Treasury Regulation § 25.2702-5 is subject to the procedures described in the New York State Constitution, the State Administrative Procedure Act and the Executive Law; that Federal regulations must be promulgated and filed with the Secretary of State; and that the New York State Attorney General has stated that Federal regulations are subject to the notice and filing requirements that apply to New York State regulations. In the alternative, petitioner argues that the Commissioner exceeded his authority because Treasury Regulation § 25.2702 alters, adds to and is inconsistent with IRC § 2702. Petitioner further submits that the Commissioner's prior position for a period of six years of allowing the subtraction of the value of a retained interest creates a presumption in favor of the taxpayer. Lastly, petitioner maintains that the Legislature did not incorporate section 25.2702-5 into the statute and that the Commissioner has acted in bad faith.

12. In response to the foregoing, the Division argues: that the Internal Revenue Code is controlling in determining the amount of the taxable gift; that the notice and filing requirements of the State Administrative Procedure Act do not apply in this case; that Treasury Regulation § 25.2702-5 has the force and effect of law; and, that the Division did not act arbitrarily in correcting its erroneous interpretation of IRC § 2702.

13. In her reply brief, petitioner argues: that the doctrine of conformity does not relieve the Commissioner of the notice, hearing and filing requirements set forth in the State Administrative

Procedure Act, the Executive Law and the State Constitution; that Treasury Regulation § 25.2702-5 does not have the force and effect of law; that the Commissioner's duty to correct an erroneous interpretation of the law does not rebut the presumption in favor of the taxpayer arising from the long-standing practice of the Commissioner; and the Commissioner has not acted in good faith toward petitioner. Petitioner submits that the true reason why the Commissioner allowed taxpayers to subtract the value of the retained interest after the enactment of the special valuation rules is because the special valuation rules found in IRC § 2702 violate the prohibition against enacting existing law by reference found in section 16 of Article III of the New York State Constitution.

#### ***CONCLUSIONS OF LAW***

A. Tax Law former § 1001 imposed a tax on the transfer of property by gift. The gifts of a New York resident were defined as “the total amount of gifts made in a calendar year within the meaning of section two thousand five hundred three of the internal revenue code” with certain qualifications which are not pertinent to this matter (Tax Law former § 1003[a] [1]). Former subdivision (e) of section 1004 of the Tax Law provided that, except to the extent that it was inconsistent with the provisions of Article 26-A of the Tax Law, certain enumerated provisions of the Internal Revenue Code were considered pertinent to the computation of New York taxable gifts. In particular, this section included Internal Revenue Code § 2702 which sets forth the special valuation rules.

B. Where New York and the Federal government have substantially similar tax provisions, it has long been the policy of the courts, whenever reasonable and practicable, to adopt the Federal construction (*see, Matter of Marx v. Bragalini*, 6 NY2d 322, 189 NYS2d 846, 854). For example, the principle of Federal conformity was applied by the Court of Appeals in

*In re Weiden's Estate* (263 NY 107 [estate tax]) and *Matter of Hunt v. State Tax Commn.* (65 NY2d 13, 489 NYS2d 451 [personal income tax]), and the Appellate Division in *Matter of Dreyfus Special Income Fund v. New York State Tax Commn.* (126 AD2d 368, 514 NYS2d 130 [corporation franchise tax] *affd* 72 NY2d 874; 532 NY2d 356) and *Matter of Behm* (19 AD2d 234, 241 NYS2d 264 *affd* 14 NY2d 826; 251 NYS2d 425 [estate tax]). When the principle of Federal conformity is applicable, it is the practice of the courts to utilize Federal regulations as an aid in ascertaining the meaning of the pertinent statutes (*see, e.g., Matter of Dreyfus Special Income Fund v. New York State Tax Commn., supra*).

C. In this matter, petitioner objects to the fact that the Division employed the provisions of IRC § 2702 and Treasury Regulation §§ 25.2702-1 and 25.2702-5 to conclude that the value of the interest retained by the donor was zero. Before addressing the specific arguments, it is noted that petitioner has not argued that the Division misapplied the provisions of IRC § 2702 and Treasury Regulation §§ 25.2702-1 and 25.2702-5 as interpreted by the Internal Revenue Service. Rather, it is the application of these regulations which is considered objectionable.

D. Petitioner argues that she is entitled to prevail because the Commissioner did not promulgate Treasury Regulation § 25.2702-5 pursuant to the procedures found in State Administrative Procedure Act §§ 202, 203; Executive Law § 102 and Article IV (§ 8) of the New York State Constitution. Article IV (§ 8) of the New York Constitution provides, in pertinent part, as follows:

No rule or regulation made by any state department, board, bureau, officer, authority or commission, except such as relates to the organization or internal management of a state department board, bureau, authority or commission shall be effective until it is filed in the office of the department of state. . . .

Section 102 of the Executive Law provides, in part, that no code, rule or regulation is effective unless it is filed with the Secretary of State, and sections 202 and 203 set forth the rule making procedure and principles regarding the filing and effective date of rules.

E. In general, petitioner is correct that in order for an administrative agency's interpretation of a statute through a rule or regulation to be enforceable, it must be duly adopted and filed (*see, e.g., Research Institute of America v. Department of Taxation and Finance*, 99 Misc 2d 243, 415 NYS2d 928; *see also, Matter of Wegmans Food Markets v. Dept. of Taxation and Finance*, 126 Misc 2d 144, 481 NYS2d 298, *affd* 115 AD2d 962, 497 NYS2d 790, *affd* 67 NY2d 606, 501 NYS2d 1025). However, this does not mean that the Division's interpretation of Tax Law § 2702 is not enforceable. First, it must be kept in mind that this was a situation where the Division was presented with the question of how to interpret a New York statute which incorporated a Federal statute. In response, the Division utilized the Federal definition. In view of the fact that the New York State Gift Tax Law referred to the provisions of the Federal gift tax law, it was clearly reasonable to follow the Federal construction.

The authorities cited by petitioner are distinguishable on their facts. In *Matter of Wegmans Food Markets v. Dept. of Taxation and Finance (supra)* the court disapproved of the use of private letter rulings to interpret various sections of the Tax Law because they were not promulgated pursuant to the New York State Constitution, the Executive Law or the State Administrative Procedure Act. Similarly, in *Research Institute of America v. Department of Taxation and Finance (supra)*, the court rejected the use of an information letter to interpret the statutory exemption for "periodicals." Neither of these cases involved the use of a Federal regulation to interpret a Federal statute and therefore have no bearing on this matter.

In *New York State Coalition of Public Employers v. New York State Dept. of Labor* (60 NY2d 789, 469 NYS2d 679) the Commissioner of Labor promulgated and published in the State Register a proposed rule which incorporated by reference all of the standards found in two parts of the Code of Federal Regulations. The Court concluded that this action by the Commissioner of Labor violated section 8 of article IV of the New York State Constitution. Petitioner's reliance upon this case is also misplaced. As noted earlier, this is not an instance where the Division incorporated a Federal regulation.

Lastly, petitioner's reliance upon an opinion of the Attorney General (1980 Op Atty Gen 198) does not warrant a ruling in petitioner's favor. In this opinion, the Attorney General concluded that section 16 of Article III of the Constitution, which prohibits the Legislature from passing a bill which incorporates by reference all or part of an existing law, did not apply to administrative regulations. It was also determined that, in accordance with section 8 of Article IV of the Constitution, a New York State regulation which incorporated a Federal regulation must be filed with the Secretary of State. Significantly, the opinion stressed that the Constitution required that the New York State agency's regulation, not the Federal regulation, be filed with the Secretary of State. Again, as noted earlier, this is not a situation where the Division is applying an unfiled regulation which incorporates a Federal regulation.

F. In reaching the conclusion that petitioner's first argument is without merit, I am mindful of the fact that acceptance of petitioner's position would lead to an anomalous result. Despite the broad policy of Federal conformity that is present in significant portions of the New York State Tax Law, the Division and the courts would be prohibited from applying this policy unless the entire body of Federal Treasury Regulations and other interpretative materials were adopted and filed as New York State rules and regulations.



G. Petitioner next argues that Treasury Regulation § 25.2702-5 is inconsistent with Internal Revenue Code § 2702 as enacted by the New York State Legislature in 1992 in Tax Law § 1004(e). In response, the Division contends that Treasury Regulation § 25.2702-5 has the force and effect of law. It is further argued that Treasury Regulation § 25.2702-5 went into effect on February 27, 1992 and that in 1996 Congress made technical corrections to section 2702 of the Internal Revenue Code. The Division submits that this action was taken with full knowledge of the construction placed upon the statute and that if Congress had considered the interpretation placed upon the statute erroneous, it would have amended this section. According to the Division, the failure to amend the statute requires the conclusion that the regulation is not inconsistent with the statute. Lastly, the Division of Taxation argues that the Division of Tax Appeals lacks the jurisdiction to rule on the validity of Treasury Regulations.

H. As noted by petitioner, IRC § 2702(a)(3) sets forth exceptions to the special valuation rules, in part, as follows:

(3) Exceptions

(A) In General. This section shall not apply to any transfer -

(i) if such transfer is an incomplete gift,

(ii) if such transfer involves the transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interest in such a trust . . . .

Petitioner notes that in this case the deed reserved a life estate to the grantor for the grantor's use as a personal residence and that by virtue of the plain language in IRC § 2702, this transaction was exempt from the special valuation rules. Nevertheless, Treasury Regulation § 25.2702-5 imposes the additional requirement that a qualified personal residence trust be used in order to qualify for the personal residence exemption.

I. The foregoing argument is without merit. The question presented is whether the Division has adopted a proper construction of the statute. In view of the policy of Federal conformity mentioned earlier, the Division's reliance upon Treasury Regulation § 25.2702-5 was clearly appropriate. Moreover, as pointed out by the Division, the intent behind the enactment of IRC § 2702 was "to correct certain abuses perceived by the IRS resulting from partially completed transfers among family members which artificially depress the value of the gift, while, in fact, the donor retains substantial control." (Fastman, *Transferring the Family Home: Gift Tax Implications*, NYLJ, December 8, 1997, at 1.) This is exactly what is accomplished by Treasury Regulation § 25.2702-5.

There is an additional factor which supports the Division's decision to rely upon the regulation in issue. Treasury Regulation § 25.2702-5 went into effect on February 27, 1992. Congress made technical corrections to IRC § 2702 in 1996 (Pub L 104-188, § 1702[f]). At the time Congress was obviously aware of the construction placed upon the section by the Internal Revenue Service. If Congress had regarded this interpretation as erroneous, the section would have been amended (*see, Wheeler v. United States*, 116 F3d 749 [5th Cir 1997]).

J. Relying upon *Matter of Consolidated Edison Co. of N.Y. v. State Tax Commn.* (24 NY2d 114, 299 NYS2d 142) and *New York State Cable Television v. State Tax Commn.* (59 AD2d 81, 397 NYS2d 205), petitioner argues that the Commissioner's prior position for six years of allowing the subtraction of the retained interest in a primary residence results in a presumption in favor of petitioner.

The cases relied upon by petitioner are distinguishable. This is not a situation where an administrative agency has merely interpreted a New York statute. Rather, this is an instance where an administrative agency has interpreted the New York statutory scheme which is directly

tied into the Federal statutes in a consistent manner. It is obvious that the Division's prior failure to follow the Federal regulation was in error and that, under these circumstances, the Division was obligated to correct the mistake (*Matter of AT&T Information Systems v. Donohue*, 68 NY2d 821, 507 NYS2d 614).

K. Petitioner's contention that the change in the interpretation of IRC § 2702 was in bad faith in order to recoup lost funds is without any basis and rejected.

L. The petition of Angelina Delese is denied.

DATED: Troy, New York  
October 11, 2001

/s/ Arthur S. Bray  
ADMINISTRATIVE LAW JUDGE