



Taxpayer Wins in 9th Circuit Family LLC Case

Linton v. United States, 2011 WL 182314 (C. A.9 (Wash))(Jan. 21, 2011)

On Jan. 22, 2003, the Lintons met with their tax attorney to sign and date several documents to form and fund a limited liability company (LLC) with real property as well as cash and securities. At the same meeting, they signed but *did not date* the agreements that purported to give their children's trusts equal interests in the LLC.

Attorney error. A couple of months later, the Lintons' tax attorney filled in "January 22, 2003) as the missing date on the trust and gift agreements—but later testified that he meant to insert January 31, 2003. The Lintons' accountant and appraiser corroborated the lawyer's testimony, and in addition, his preparation of the taxpayers' return shows an initial credit of LLC assets to their individual capital accounts and then subsequent transfers to the children's trust accounts. The LLC's ledger (prepared by the attorney) and an LLC valuation (prepared by the appraiser) showed a similar train of subsequent transfers. Based on this appraisal, the taxpayers also claimed a 47% combined discount for lack of marketability and control on their federal gift tax returns.

The IRS rejected the discount, claiming that the taxpayers made indirect gifts of property to their children's trusts; or, in the alternative, the step transaction doctrine collapsed the transfers into a single gift. The taxpayers disputed the deficiencies in federal district court (Washington). On the government's summary judgment motion, the court relied on the express language of the trust and gift documents to find that the taxpayers' contributions occurred with or just after their gifts of LLC interests to the children's trusts, and thus constituted indirect gifts of the cash and property. In the alternative, even if the LLC contributions occurred prior to the gifts of LLC interests, the step transaction doctrine applied. The taxpayers never decided to delay the gifts, the district court noted, and no evidence suggested that the trust property was never exposed to any "real economic risk" during the nine days that allegedly lapsed between the initial LLC funding and subsequent gifts to the children's trusts.

The taxpayer appealed to the U.S. Court of Appeals for the Ninth Circuit, which found that the signing and dating of the relevant documents created a "considerable objective ambiguity" as to when the taxpayers intended their gifts to become effective. Because the record failed to resolve this ambiguity, the Ninth Circuit remanded the case for the district court to find when the

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taxpayers “objectively manifested the intent to donate the LLC interests” under applicable state law (Washington) by putting the gift documents “beyond retrieval.”

LLC is a ‘business activity that makes sense.’ The court also found that the step transaction doctrine did not apply, because in this case, ample evidence supported the taxpayers’ intent to convey the LLC interests to their children without also conveying ownership or management interests. Importantly, the court also found that the taxpayers’ steps were not so interdependent that one would be fruitless without the completion of the others. “The placing of assets into a limited liability entity such as an LLC is an ordinary and objectively reasonable business activity that makes sense with or without any subsequent gift,” the court held. The taxpayers’ creation and funding of the LLC enabled them to specify the LLC terms and to contribute a desired type and amount of assets. These “reasonable and ordinary” business activities did not meet the requirements of the interdependence test, the court held, and reversed summary judgment by the district court.