TAX COURT CASE UPDATE

Citation:

Linton v. United States, 2011 WL 182314, 9th Circuit Court of Appeals, January 21, 2011.

Overview:

The 9th Circuit Court of Appeals reversed the district court on its summary judgment ruling that the taxpayers made indirect gifts of cash and property to their children, and that if this argument had not prevailed, that the step transaction doctrine applied.

The Facts:

In 2003, the Lintons created a Washington limited liability company (LLC) and transferred assets to it. At the same time, they created trusts for their children with the intentions of transferring one quarter of the LLC's units to each of these trusts. When they met with their attorney, the Lintons signed the trust documents but did not date them. The LLC was created on January 22, 2003 and the interests were supposed to be transferred to the trusts on January 31, 2003. However, when the attorney dated the trust agreements, he dated them January 22, 2003.

The Lintons filed Form 709 reporting gifts made on January 31, 2003. According to the appraisal prepared at that time, a combined discount of 47 percent was claimed. The IRS rejected the discount claiming that the Lintons 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.

At trial, on a summary judgment hearing, the district court found that the Lintons' contributions occurred either simultaneously with or after their gifts of LLC interests to the children's' trusts, and therefore, were indirect gifts of the cash and property. In the alternative, even if the LLC contributions occurred prior to the gifts of the LLC interests, the step transaction doctrine applied since the Lintons made no decision to delay the gifts and there was no evidence to suggest that the trust property was exposed to "real economic risk" between January 22 and January 31.

The Lintons appealed to the U.S. Court of Appeals for the 9th Circuit.

Discussion:

The 9th circuit reviewed the elements required to complete a gift under Washington law. These elements include the donor's intent to make a gift, a delivery of the gift, and acceptance by the donor. The court determined that the evidence was incomplete to determine when the Lintons intended to gift the LLC interests and remanded the case back to the district court to determine this.

The 9th circuit then moved on to the step transaction doctrine. The court discussed the three tests to be considered to apply this doctrine, one of which must apply. The tests are:

1. The “end result” test which asks whether a taxpayer intended a series of steps to produce a particular result, and if so, it treats the steps as one. In this instance, the Court ruled that even if the steps could be merged, the end result would be that the gifts would be taxed as the Lintons intended.

2. Did the first step trigger a “binding commitment” to fulfill the remaining steps? This test only applies if a transaction will occur over multiple years which was not applicable here.

3. Are the steps “so interdependent” that the legal relations created by one would be fruitless without completion of the remainder? In this case, the Court ruled that the creation of an LLC is a business decision and does not rely on gifting for its existence.

Conclusion:

The 9th circuit reversed the district court on both issues.