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*David E. Heckerman et ux. V. United States; No. 2:08-cv-00211, July 27, 2009*

The Facts:

During the fall of 2001, David Heckerman and his wife (“Mr. and Mrs. Heckerman” or “the Heckerman’s”) sought advice regarding setting up a plan to pass along property to their two minor children that would make the children both “work for their money” and “not trigger a gift tax”. The Heckerman’s spoke with several legal and financial advisors and eventually drew up a plan that involved creating LLC entities, transferring property and cash into these LLC entities, and then transferring minority shares to trusts established for the children.

On November 28, 2001, the Heckerman’s established trusts (the J.H. Trust Agreement and the R.T.H. Trust Agreement) for each of their children. Each trust agreement appointed Edward Mark Heckerman (Mr. Heckerman’s brother) and Ms. Susan Bruska (Mr. Heckerman’s sister-in-law) as trustees.

Also on November 28, 2001, the Heckerman’s formed three separate corporate entities: Heckerman Investments LLC, Heckerman Real Estate LLC, and Heckerman Family LLC. Heckerman Investments LLC and Heckerman Real Estate LLC were both 100% owned by Heckerman Family LLC.

Mr. and Mrs. Heckerman began funding the LLCs on December 28, 2001, with an ownership transfer of a \$2,050,000 Malibu beach house to Heckerman Family LLC (and with an immediate quitclaim deed from Heckerman Family LLC to Heckerman Real Estate LLC). At this time, the Heckerman’s owned 100% of Heckerman Family LLC which in turned owned 100% of Heckerman Real Estate, LLC.

On January 11, 2002, Mr. and Mrs. Heckerman transferred \$2,850,000 in mutual funds from their personal Charles Schwab investment account to Heckerman Investments LLC. Mr. and Mrs. Heckerman also transferred 1,217.65 units in Heckerman Family LLC to each of their children’s trusts with signed gift documents stating that the effective date of the assignments was to be January 11, 2002. These units constituted just under a 50% equity interest in Heckerman Family LLC.



The Heckerman's hired an independent appraiser to complete a valuation of the Heckerman Family LLC units gifted to the trusts. The appraiser determined that the transfers would be subject to a 58% discount for lack of marketability. Both Mr. and Mrs. Heckerman had transferred gifts valuing \$1,022,000 and had used four annual exclusions and two \$1,000,000 gift exemptions, and there was no gift tax payable.

The IRS subsequently audited the gift tax return and claimed that the securities transfer was an indirect gift of securities and assessed a gift tax of \$511,497.56 for each Mr. and Mrs. Heckerman. The Heckerman's paid the gift tax and then filed for a refund.

#### The Arguments:

The IRS argued that under Reg. 25.2511-1(a), "whether the gift is direct or indirect" there was a transfer, and because the transfer of the investment assets to Heckerman Investments LLC was completed on the same date as the gift of the units (and there was no clear evidence that the transfer of the units was after the funding of the LLC), the IRS claimed an indirect gift was made. In addition, the IRS argued that a step transaction had occurred.

The Heckerman's argued that the gifts were made after the funding took place attempting to utilize the argument that they did not remember the exact date they signed the paperwork, however, it was highly unlikely that they signed the documents on January 11, 2002, as they normally handled personal affairs on the weekends, so the earliest they may have signed the documents was January 12, 2002.

#### The Findings:

The Court upheld both IRS positions stating that the gifts of LLC interests were apparently not signed until after January 11, 2002, but were "effective as of January 11, 2002." Therefore the transfer process created an indirect gift on the theory that the children's trusts actually owned the LLC units when the investment assets were transferred to Heckerman Investments LLC. Furthermore, citing *Senda v. Commissioner*, a step transaction occurred because the transfer of \$2,850,000 of investment assets to Heckerman Investments LLC and the gifting of LLC units to the children were an "integrated transaction", which created an indirect gift.

#### Parting Thoughts:

Lost in this court case is the fact that the IRS did not object to the 58% discount for lack of marketability for the transfer of the real estate on December 28, 2001, and gift just two weeks later. Thus, even with only a two week period between the LLC funding and LLC unit gifting, a substantial discount was allowed. Even more perplexing to me was that there is no discussion of a minority interest discount being applied by the appraiser, but instead only a very large 58% discount for lack of marketability.