

UNITED STATES TAX COURT
WASHINGTON, DC 20217

RICHARD M. HELLMANN & DIANNA G. HELLMANN, ET AL.,	)	
Petitioners,	)	
v.	)	Docket No. 8486-17, 8489-17, 8494-17, 8497-17.
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

O R D E R

The parties in these consolidated cases have filed cross-motions for summary judgment. We heard oral argument on those motions in Atlanta on September 10, 2018. In light of the arguments and the questions raised by the Court, we believe that further factual development, through trial or possibly through a supplemental stipulation of facts, is necessary to enable the Court to rule on the question presented.

These cases involve expense deductions claimed by GF Family Management, LLC (GFM), an investment management firm owned and operated by petitioners. Petitioners are members of the same family, and GFM is a "family office" as defined by the Federal securities laws. See 17 C.F.R 275.202(a)(11)(G)-1(b)(1) and (d)(4). Each petitioner held a 25% profits interest in GFM, and the assets managed by GFM were held by six investment partnerships. GFM held a 1% interest in each partnership, and trusts of which petitioners are the beneficiaries held (individually or collectively) the remaining 99% of each partnership.

The question presented for decision is whether GFM, during the 2012-2014 tax years in question, was engaged in a "trade or business" within the meaning of section 162.[1] If so, GFM was entitled to claim ordinary business expense deduc-

[1]All ensuing statutory references are to the Internal Revenue Code (Code) in effect for the years in question. All Rule references are to the Tax Court Rules of Practice and Procedure.

SERVED Oct 01 2018

tions for its operating costs, such as salaries, rent, and investment expenses. Respondent contends that GFM was not engaged in a "trade or business," but rather was engaged in activity "for the production or collection of income" or "for the management, conservation, or maintenance of property held for the production of income," within the meaning of section 212.

If respondent is correct, petitioners as members of GFM would receive less advantageous tax treatment. In that event, GFM's expenses, when passed through to them, would constitute "miscellaneous itemized deductions" subject to the 2% floor on deductibility imposed by section 67(a). Deductions under section 212 may be further limited by application of the alternative minimum tax. See sec. 56(b); Guill v. Commissioner, 112 T.C. 325, 328-329 (1999). And carryover of net operating losses is permitted only if those losses were incurred in operating a "trade or business." See sec. 172(a), (d)(4); Todd v. Commissioner, 77 T.C. 246, 248 (1981), aff'd, 682 F.2d 207 (9th Cir. 1982).

The Court may grant summary judgment when there is no genuine dispute as to any material fact and a decision may be rendered as a matter of law. Rule 121(b); Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992), aff'd, 17 F.3d 965 (7th Cir. 1994). The moving party bears the burden of showing that there is no genuine issue of material fact. "If there exists any reasonable doubt as to the facts at issue, the motion must be denied." Ibid.

The question presented here was recently presented, on a different set of facts, in Lender Management, LLC v. Commissioner, T.C. Memo. 2017-246. There, one family member held a 99% profits interest in the management firm. The assets under management were beneficially owned by siblings, children, and grandchildren in the extended Lender family. The family member who held the 99% profits interest in Lender Management held no more than an 11% interest in any of the trusts that held the investment assets. Id. at *9.

In Lender Management the family members who held interests in the investment trusts "were geographically dispersed," residing in numerous different states and at least two foreign countries. Id. at *4,*15, *36. Many family members "did not know each other, and some were in such conflict with others that they refused to attend the same business meetings." Id. at *36. Because the family members had differing financial needs and risk tolerances, Lender Management "provided individual investors in the investment LLCs with one-on-one investment advisory and financial planning services." Id. at *13. It maintained computer models "that projected the cash needs of individual investors." Id. at *17. It also developed

financial products that allowed family members "to participate in investments more directly suited to their age and risk tolerance." Id. at *16.

We emphasized in Lender Management that the trade-or-business determination "requires an examination of the facts in each case." Id. at *24 (citing Higgins v. Commissioner, 312 U.S. 212, 217 (1941)). Evaluating all the facts in Lender Management, we held that the family office, which operated in some ways like a hedge fund, id. at *10, *29, *38, was engaged in a "trade or business" within the meaning of section 162.

Generally, investment activities performed for one's own account do not constitute a "trade or business." Id. at *25 (citing Whipple v. Commissioner, 373 U.S. 193 (1963); Higgins, 312 U.S. at 218). This rule does not change merely because those activities are aggregated and undertaken by a separate legal entity. Lender Management at *9, *28. However, an investment firm that provides real added value to its investors will not be denied status as a "trade or business" merely because there is some overlap between the investors and the managers. Id. at *38; see Dagres v. Commissioner, 136 T.C. 263, 285 (2011). Whether a family office or similar closely-held management firm is engaged in a "trade or business" turns on a variety of factors, including the nature and value of the services performed and compensation received.

These cases appear to resemble Lender Management in some respects, but not in others. GFM is a family office that managed investment assets for four family members. All four family members resided in the Atlanta metropolitan area and appear to have been on good terms. GFM received performance-based compensation keyed to the success of the investments it made. One investor, Mark Graham, appears to have had authority over day-to-day investment decisions. But here, unlike in Lender Management, all of the other investors were also owners of the management company, with each investor holding a 25% profits interest in GFM.

Each party contends that summary judgment may be granted in his favor on the basis of the Court's legal rulings and factual findings in Lender Management. From our review of the facts currently contained in the record, we do not think that opinion dictates a ruling in favor of either side as a matter of law. In Lender Management we relied on a variety of factors tending to prove (or disprove) the existence of a "trade or business." Besides the manner in which the family office was compensated for its services, relevant factors may include but are not necessarily limited to: (1) the nature and extent of the services provided by the family

office employees; (2) the relative amounts of expertise possessed and time devoted by family office employees versus outside investment managers and consultants; (3) the individualization of investment strategies for different family members with differing investment preferences and needs; and (4) the proportionality (or lack thereof) between the share of profits inuring to each family member in his or her capacity as an owner of the family office and the share of profits inuring to that same individual in his or her capacity as an investor in the managed funds.

In cases such as these, an important question is whether the owners of the family office are "actively engaged in providing services to others," Lender Management, at *26, or are simply providing services to themselves. See Dagres, 136 T.C. at 281 ("Selling one's investment expertise to others is as much a business as selling one's legal expertise."). Here, each family member had a 25% profits interest in GFM. If each family member (for example) also had an aggregate 25% interest in the assets under management, there would be perfect proportionality between the two streams of income. In that event, it would not matter how GFM was compensated, because that compensation, once distributed ratably to the four owners, would simply replace investment income that each person would otherwise have derived from the investment portfolios. That was not the case in Lender Management, where one family member had a 99% profits interest in the management company, but held only minority interests in the assets under management. The facts currently in the record do not enable the Court to assess the degree or proportionality (or lack thereof) here.

We conclude that further factual development is necessary to shed light on this and other questions. Relevant facts may include the following:

- The education and professional background of each investor-employee.

- The work schedules of each investor-employee, with descriptions of the general work performed. Ideally, this information would include approximate hours worked weekly or monthly.

- Any details pertaining to the decision process by which GFM was selected as the management company, the decision process by which Mark Graham was chosen as GFM's manager, and the identities of any other candidates considered for these two roles.

- The net asset value of each investment partnership, on a quarterly, semi-annual, and/or annual basis, during the 2012-2014 tax years in question and also during 2011 and 2015.

- The aggregate percentage ownership interest that each of the four family members had in the total assets held by all the investment partnerships. Such percentage figures might be provided on a quarterly, semi-annual, and/or annual basis, for the 2012-2014 tax years in question and also for 2011 and 2015.

- Information concerning the major investments held by each investment partnership and the estimated dollar value of those investments.

- The similarities and distinctions between the investment strategies and objectives of each investment partnership. Relevant distinguishing factors might include average asset turnover, relative investment horizons, and the relative risk and nature of the investments made.

- How (if at all) the investment strategies and objectives of the partnerships were tailored to the individual needs and preferences of the four family members.

- Any additional facts the parties believe would be relevant to the "trade or business" analysis as undertaken in Lender Management.

We will ask the parties to file a joint status report expressing their views as to whether these facts should be developed by allowing these cases to proceed to trial or (alternatively) whether the factual record can be adequately supplemented with a supplemental stipulation of facts, permitting these cases to be summarily adjudicated. In the latter case, we will ask the parties to express their views as to whether the cases could appropriately be submitted for decision without trial under Rule 122. The parties are reminded that submission of a case under Rule 122 does not alter the burden of proof, the requirements otherwise applicable with respect to adducing proof, or the effect of failure of proof. See Rule 122(b).

In consideration of the foregoing, it is

ORDERED that jurisdiction of these consolidated cases is retained by this Division of the Court. It is further

ORDERED that the parties shall submit a joint status report, on or before November 5, 2018, addressing the matters set forth above.

(Signed) Albert G. Lauber
Judge

Dated: Washington, D.C.
October 1, 2018