WHEN A FAMILY OFFICE BECOMES A BUSINESS: THE LENDER MANAGEMENT CASE

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When a Family Office Becomes a Business:
The Lender Management Case and the Section 162 Opportunity

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Abstract

In *Lender Management, LLC v. Commissioner*, T.C. Memo. 2017-246, the United States Tax Court held that a family office serving the family behind Lender's Bagels was engaged in a trade or business under Section 162 of the Internal Revenue Code — not merely managing the family's own investments — making its operating expenses fully deductible. The decision turned on a favorable fact pattern: the office was compensated through a profits interest comparable to a hedge-fund manager's carried interest; it delivered individualized investment advice to geographically dispersed family members with differing objectives; it operated with dedicated professional staff on arm's-length terms; and it held only a small stake in the capital it managed. Decided nine days before the Tax Cuts and Jobs Act suspended miscellaneous itemized deductions — a suspension made permanent by 2025 legislation — *Lender* now defines, for many families, the only remaining path to deductibility of family office expenses. This whitepaper reviews the case, the legal framework, the structuring lessons that advisors have drawn from it, and the important cautions that families should weigh with their own counsel.

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Introduction

Running a family office is expensive. Investment staff, research, technology, office space, accounting, custody, legal support and advisory fees can easily run into seven figures each year. For decades, families organized their affairs on the comfortable assumption that at least some of these costs would be deductible as expenses incurred for the production of income. That assumption quietly collapsed at the end of 2017, and the ground has not shifted back.

The reason lies in a distinction that runs through the entire Internal Revenue Code: the difference between **investing** and carrying on a **trade or business**. A person who manages even a very large portfolio of their own is, in the eyes of the tax law, an investor — and the expenses of investing receive markedly less favorable treatment than the expenses of a business. *Lender Management* is the most important modern authority for the proposition that a family office, properly structured, can cross that line and be treated as a business.

The stakes in one sentence: whether the same dollar of family office expense is fully deductible or effectively non-deductible can depend entirely on whether the office is characterized as a business under Section 162 or as investing under Section 212.

The Legal Backdrop: Section 162 Versus Section 212

Two provisions frame the entire question. **Section 162** allows a deduction for the ordinary and necessary expenses of carrying on a trade or business. These are “above-the-line” deductions: they are subtracted in arriving at income and are not subject to the limitations that fall on personal itemized deductions.

Section 212, by contrast, allows a deduction for expenses incurred for the production or collection of income, or for the management of property held for the production of income — in other words, the expenses of investing. Historically these were **miscellaneous itemized deductions**, allowed only to the extent they exceeded 2% of adjusted gross income under Section 67(a), and disallowed entirely for alternative minimum tax purposes. They were never as valuable as business deductions, and for many high-income families they were worth little even before 2018.

The Tax Cuts and Jobs Act then removed them altogether. New Section 67(g) suspended **all** miscellaneous itemized deductions for tax years 2018 through 2025. The 2025 budget-reconciliation law — informally, the One Big Beautiful Bill Act — made that change permanent. For today's family office, expenses that fall under Section 212 are, as a practical matter, simply lost. Expenses that qualify under Section 162 are not.

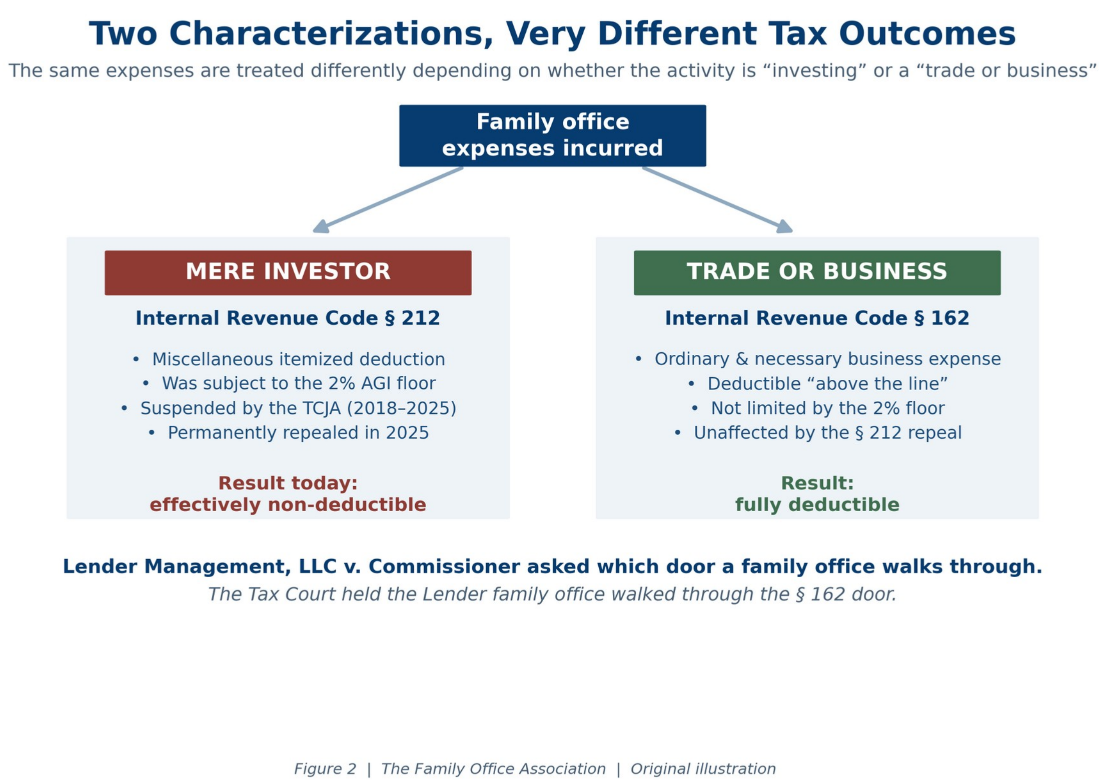

Figure 1. The same expenses lead to very different outcomes depending on characterization.

The Lender Family and the Structure

The family at the center of the case built its wealth on an American staple. Harry Lender, a Polish-Jewish immigrant, founded the New Haven, Connecticut bakery that his sons — among them Murray and Marvin Lender — grew into Lender's Bagels, the company widely credited with bringing frozen, pre-packaged bagels to supermarkets across the country. After the family sold the business, the proceeds had to be invested and stewarded across a growing number of descendants. That is the work the family office was created to do.

The office itself was **Lender Management, LLC**. Over the years at issue it was owned almost entirely through family trusts — initially the Marvin Lender Trust (with a small interest held by a revocable trust of Marvin's wife), and later, by assignment, principally the Keith Lender Trust. Keith Lender, of the third generation, served as the office's chief investment officer and managing member and devoted substantial time to the work.

Lender Management did not hold the family's money directly. Instead it managed **three separate investment LLCs**, each taxed as a partnership and each pursuing a different strategy — broadly, private equity, marketable public securities, and hedge funds. The members of those LLCs were Lender family descendants spread across multiple generations. Critically, they were not a single unified investor: they lived in different places, had different objectives, risk tolerances and cash-flow needs, and some were in conflict with one another or did not even know one another. Many of them held no interest at all in Lender Management, the manager.

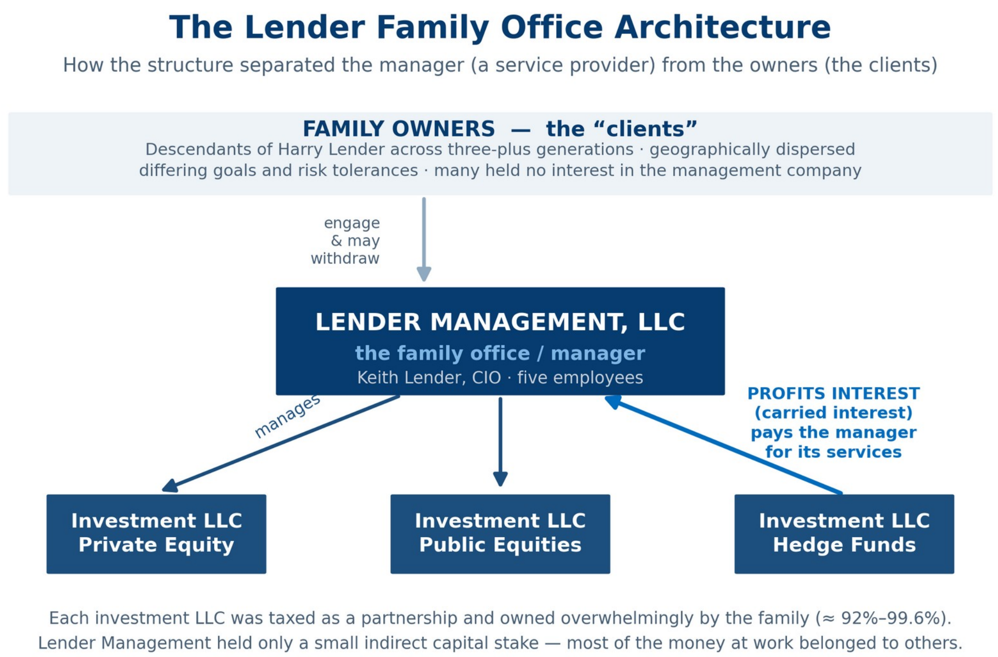

Figure 1 | The Family Office Association | Original illustration

Figure 2. The Lender family office separated the manager (a service provider) from the owners (its clients).

The economic arrangement mattered as much as the boxes and lines. In exchange for its services, Lender Management received a **profits interest** in each investment LLC — an allocation tied to the net asset value and investment performance of the pools it managed, comparable to the carried interest a hedge-fund or private-equity manager earns. Because Lender Management itself held only a small indirect stake in the underlying capital, the great majority of the money it worked with belonged to other people. It was, in substance, being paid to manage other people's wealth.

The Dispute

Lender Management deducted its operating expenses as business expenses under Section 162. The Internal Revenue Service disagreed. In the Service's view, the office was doing nothing more than managing the Lender family's own investments — a quintessential investor activity — so its expenses belonged under Section 212, subject to the 2% floor and the other limitations on miscellaneous itemized deductions. The tax years in dispute were 2010 through 2012, and the amounts were not trivial: the office's expenses exceeded roughly $1.1 million annually in the later years at issue.

The question before Judge Kerrigan of the Tax Court was therefore narrow but decisive: on these facts, was Lender Management carrying on a trade or business, or was it merely investing?

The Court's Analysis: Investor or Business?

The Code does not define "trade or business," so the court turned to the two guideposts the Supreme Court has supplied. Under *Commissioner v. Groetzinger* (1987), an activity is a trade or business if the taxpayer is involved in it with continuity and regularity, and the taxpayer's primary purpose is income or profit; a sporadic activity or a hobby will not do.

The countervailing authority is *Higgins v. Commissioner* (1941), in which the Supreme Court held that a taxpayer who merely manages his own investments — however extensive, and however much personal attention he devotes to them — is not for that reason carrying on a trade or business. *Higgins* is the reason a wealthy individual cannot simply declare the oversight of a personal portfolio to be a business. The whole of *Lender* is an exercise in distinguishing *Higgins*.

The court found that Lender Management's activities "went far beyond those of an investor." The office sourced, investigated, negotiated and monitored investments; it managed cash flow and prepared asset allocations; and — most importantly — it delivered individualized investment advice and financial planning to family members whose needs did not coincide. It employed a professional staff of roughly five people and engaged outside accountants and other providers. The court likened this to the work of a hedge-fund manager, drawing directly on *Dagres v. Commissioner* (2011), which had treated a venture-capital manager's carried interest as compensation for services performed in a trade or business.

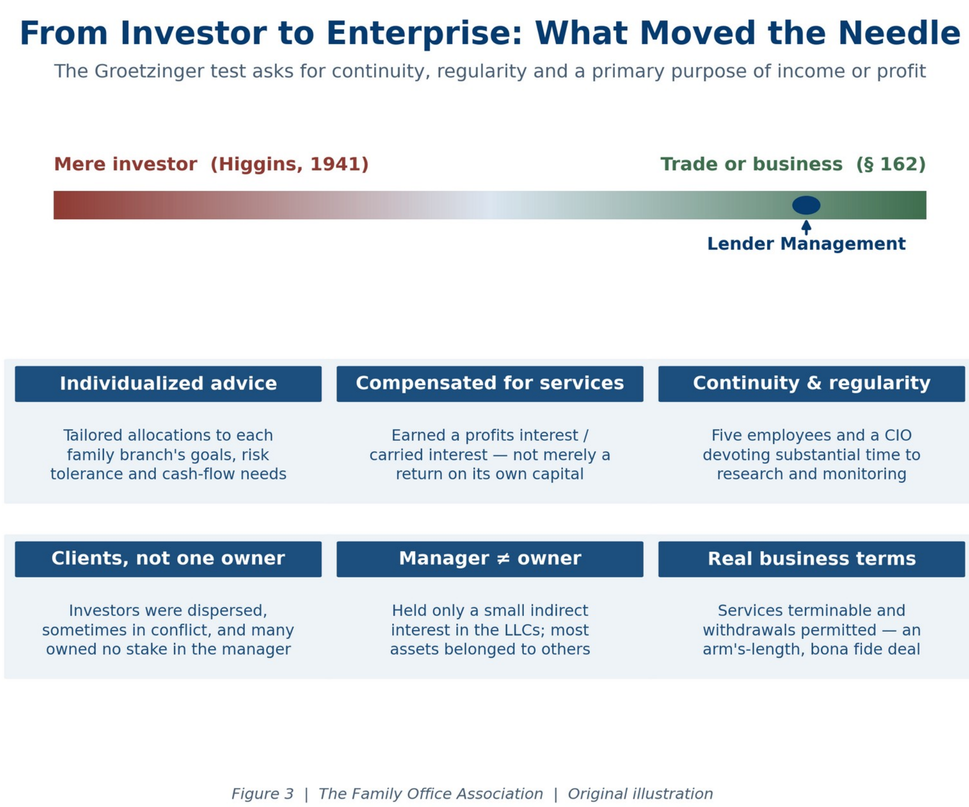

Figure 3. The factors that moved the Lender family office along the spectrum from investor to enterprise.

Because the manager and the investors were related, the court applied heightened scrutiny — related parties can dress up a personal arrangement to look like a business. But the substance held up. The family members were treated as genuine clients: they received tailored advice, they could withdraw their capital subject to liquidity constraints, and the services were terminable. The relationship, the court concluded, was a bona fide business relationship notwithstanding the family ties.

Why the Profits Interest Mattered

If a single fact carried the case, it was how Lender Management was paid. A mere co-investor earns a return *on* the capital it contributes; that return is not compensation for services, and managing one's own money is not a business. A service provider, by contrast, is paid *for* the work it performs on other people's capital — and that is precisely what a profits interest represents.

The Service argued that because the profits interest was contingent on investment success, it was really just an investment return in disguise. The court rejected that argument. Contingent pay is still pay: a hedge-fund manager's carry is contingent too, and no one doubts that a hedge-fund manager is in business. The disproportion between Lender Management's small ownership of the underlying capital and the performance-based compensation it earned was itself powerful evidence that the payment was for services rather than a return on the manager's own investment.

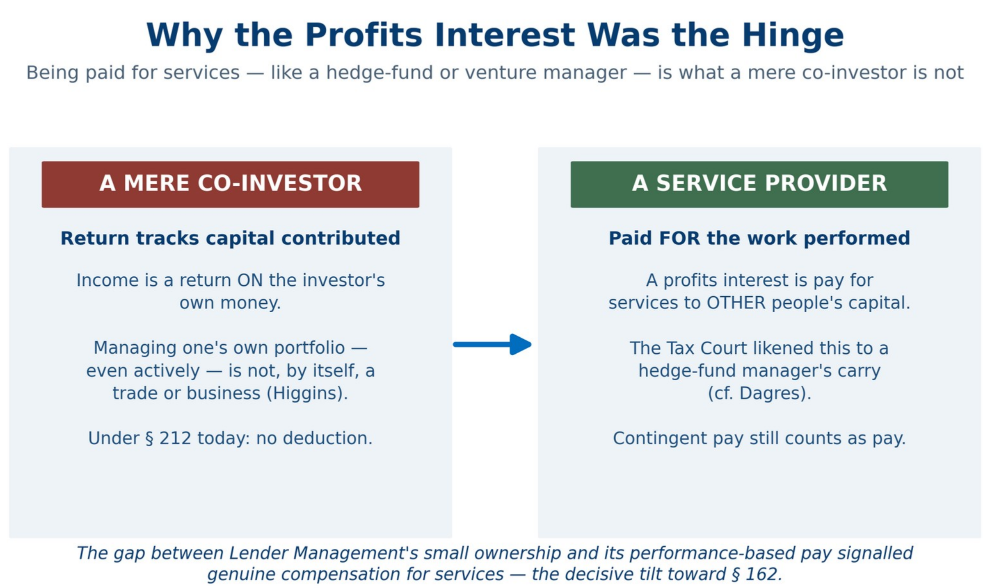

Figure 4 | The Family Office Association | Original illustration

Figure 4. Being paid for services — not merely earning a return on one's own capital — was the decisive distinction.

After Lender: The TCJA and the 2025 Permanent Repeal

The legal significance of *Lender* is inseparable from what happened next. The decision came down on December 13, 2017. Nine days later, the Tax Cuts and Jobs Act became law and, through new Section 67(g), suspended every miscellaneous itemized deduction for 2018 through 2025. Overnight, the Section 212 route that many family offices had relied on — imperfect as it already was — disappeared.

For several years, some families waited, reasoning that the suspension was temporary and would sunset after 2025. That bet did not pay off. The 2025 budget-reconciliation law made the disallowance permanent, and there is now no scheduled return of the miscellaneous itemized deduction. The practical consequence is stark: for a family office characterized as an investor, ongoing operating expenses are effectively non-deductible with no expiration date in sight. The *Lender* path is not a clever enhancement; for many families it is the difference between deductibility and none.

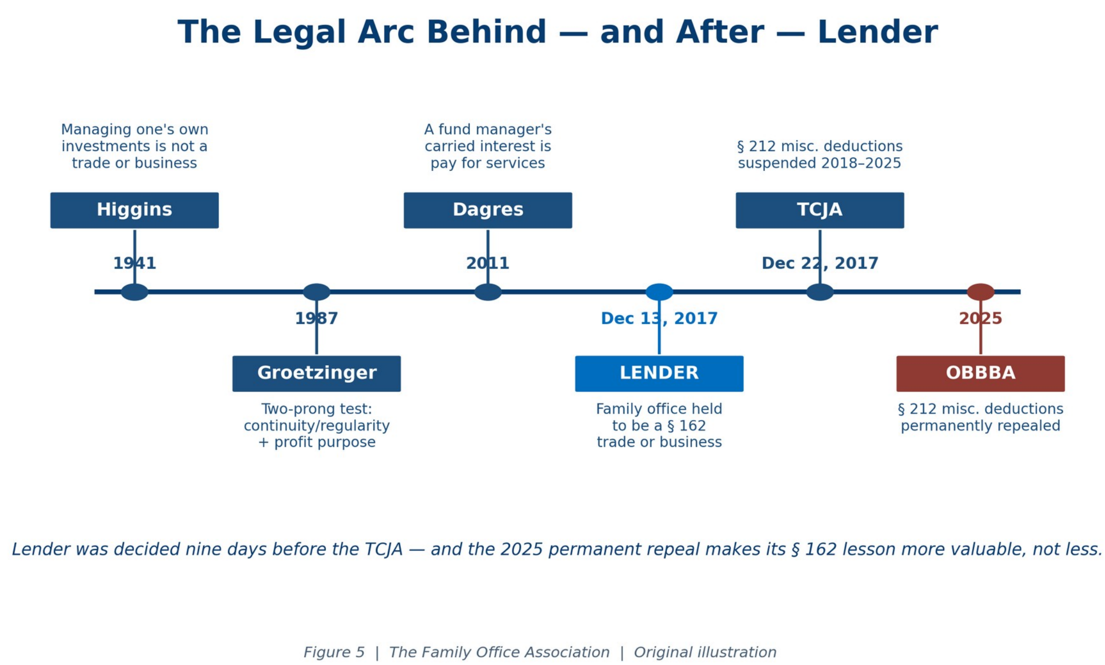

Figure 5. The legal arc from Higgins to the 2025 permanent repeal — which makes Lender's lesson more valuable, not less.

A Structuring Playbook

Commentators and advisors have distilled *Lender* into a set of design principles. None is a magic formula — the analysis is always one of facts and circumstances — but together they describe the fact pattern that a family office hoping to rely on Section 162 would like to be able to point to.

Design question	Stronger (as in Lender)	Weaker / at risk
How is the manager paid?	A profits / carried interest earned for services	Bare cost reimbursement, or nothing beyond investor returns
Who owns the capital?	Mostly other family members and trusts	The manager owns essentially all of it

Advice to whom?	Individualized advice to distinct clients	One undifferentiated family pool
Continuity & staff	Dedicated professionals; regular, ongoing activity	Ad hoc effort with no real infrastructure
Relationship terms	Arm's-length: terminable, withdrawals allowed	Informal arrangement with no business substance
Documentation	Written agreements reflecting real economics	Little or no contemporaneous documentation

Two further points recur in professional commentary. First, substance must match form: the written agreements, the compensation actually paid, and the day-to-day conduct of the office all need to tell the same story of a business serving clients. Second, the approach is only appropriate in the right situation — typically a larger, multi-generational family with genuinely distinct investors, a real professional operation, and the willingness to run the office on arm's-length terms. Retrofitting a single-investor arrangement to look like a business after the fact invites exactly the scrutiny the court applied here.

Cautions and Limitations

Enthusiasm for *Lender* should be tempered by several sober realities.

- **It is a memorandum decision on its own facts.** Lender is a Tax Court memorandum opinion, persuasive but not binding precedent, and it rests on a specific and favorable set of facts. A family whose circumstances differ — especially one where the manager and the investors are effectively the same economic unit — cannot assume the same result.
- **Related-party scrutiny is real.** The court applied heightened scrutiny precisely because the parties were family. A structure that does not have genuine business substance — real services, real clients, real arm's-length terms — is unlikely to survive.
- **Business status carries its own tax consequences.** Treating a family office as a trade or business can raise questions the case did not resolve, including self-employment tax, the net investment income tax, and the treatment of the manager's compensation. These trade-offs deserve careful modeling with qualified advisors.
- **Restructuring is not free.** Achieving a defensible Section 162 posture can require meaningful legal and operational change — separate entities, real governance, contemporaneous documentation and ongoing discipline — with costs of its own.
- **The law can change.** This whitepaper reflects developments through mid-2026. Statutes, regulations and IRS positions evolve, and later authority may refine or limit what Lender appears to permit.

Conclusion

Lender Management, LLC v. Commissioner endures because it answers, with unusual clarity, a question that sits at the heart of family office design: when does stewarding a family's wealth stop being investing and start being a business? The court's answer was that it depends on what the office actually does and how it is paid — on whether it delivers professional services to distinct clients and is compensated for those services, as Lender Management was through its profits interest, rather than simply earning a return on its own capital.

In a world where the investor's deduction has been permanently withdrawn, that answer has only grown in importance. *Lender* does not hand every family a deduction; it describes the conditions under which one may be available, and it rewards genuine substance over labels. For families with the scale, complexity and discipline to meet those conditions, it remains one of the most valuable decisions of the modern family office era — and a reminder that thoughtful structure, undertaken with expert counsel and for real business reasons, is worth the effort.

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About The Author

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