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Deducting Family Office Investment Expenses After Lender

Robert Daily*

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I. INTRODUCTION

In 2017, two tax developments sent shockwaves throughout the family office community. First, the Tax Court, in Lender Management v. Commissioner, held that a multi-generational family office was a trade or business and could take above-the-line deductions for operating expenses it incurred.1 Second, Congress passed the 2017 Tax Act (commonly known as “TCJA”2) which disallowed operating expenses for taxpayers engaged in a profit-seeking activity like investing.3 Before the TCJA, taxpayers had an incentive to argue they were engaged in a trade or business: expenses would be fully deductible if they were and limited if they were only engaged in a profit-seeking activity.4 But the combination of Lender and the 2017 Tax Act made that incentive even greater for family offices.5

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2 That said, TCJA was not the Bill’s official name. See Pub. L. No. 115-97, 131 Stat. 2054 (2017) (noting that the official name of the bill is “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018”).
3 See id. § 11045 (disallowing a taxpayer from taking a section 67(a) miscellaneous itemized deduction, which included section 212 deductions for a taxpayer incurred expenses in connection with a profit-seeking activity).
4 Compare I.R.C. § 162 (“There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . .”), with I.R.C. § 67(a) (“In the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income.”).
5 See Farhad Aghdami & Michelle L. Harris, IRS Gets “Bageled” in Tax Court Over Family Office Expenses, WILLIAMS MULLEN (Sept. 28, 2018), https://www.williamsmullen.com/news/irs-gets-%E2%80%9Cbageled%E2%80%9D-tax-court-over-family-office-expenses-1 (“[The Lender] decision is particularly notable because it affirms the ability of a family office to be respected as a trade or business for federal income tax purposes—an ability that is particularly important under the new tax reform legislation.”); Mark Leeds, New Tax Case Provides Guidance on Deductions for Fees Incurred by Family Offices, MAYER BROWN (2018), https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2018/01/new-tax-case-provides-guidance-on-deductions-for-f-family-offices.pdf (noting that The TCJA (i.e., the Section 11045 repeal of the miscellaneous itemized deductions) puts “an even more important significance” on “the distinction between business expenses and investment expenses.”).
In response to this incentive, law firms and accounting firms have encouraged clients to create structures like the taxpayer’s structure in *Lender.* The cost savings associated with a *Lender* structure were and remain substantial. Family members investing through a family office structure now can take immediate ordinary income tax deductions yet pay tax at the preferential long-term capital gains rate. Because family offices are implementing this structure at a rapid pace, a thorough understanding of the core issues in *Lender* is timely and necessary.

The theoretical starting point for this discussion is an analysis of whether a family office is a trade or business. The Supreme Court long ago established “[n]o matter how large the estate or how continuous or extended the work required may be,” a taxpayer who solely manages investments for himself will not be engaged in the trade or business of investing. Courts have since only drawn two exceptions: when the taxpayer acts as a conduit for investors (dealer) or derives profits from active trading (trader). Some courts have created a third exception for private equity and venture capital funds even though these taxpayers fall somewhere between the dealer and investor label. The *Lender* court eschewed the traditional trade or business test, finding instead that the family office was a trade or business because it operated like a traditional investment fund and received a profits interest for the services it performed.

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7 KIRKLAND & ELLIS, supra note 6 (“Depending on the size of the family office and number of existing entities, implementing the profits interest family office structure can be complicated, although the benefits usually well outweigh the cost.”).

8 A third prong of the *Lender* decision is that by putting assets into a family partnership structure, the estates of the individuals who own a beneficial interest in the family partnerships will pay less in estate tax. Lender Mgmt., LLC v. Comm’r, T.C. Memo. 2017-246, 114 T.C.M. (CCH) 638 (2017). A discount of 10-20% is common in these situations. See generally Louis A. Mezzullo, Wealth Planning with Family Limited Partnerships and Limited Liability Companies, 722 TAX MGMT. PORTFOLIOS (BNA), at I.C. (acknowledging the potential estate tax benefit of putting assets in an investment LLC, similar to what the Lender family did, but not discussing this potential benefit).


10 See infra Part II.A.
While the Lender decision was no doubt a positive one for taxpayers, some family offices may not celebrate that decision as much as one would expect. First, a few aspects of the Tax Court’s decision are not persuasive. Future courts may find the court’s analysis of the family office’s profit interest structure was lacking relative to the varied ways in which a family office can create a profits interest. Courts may also adopt a different standard from which to evaluate the trade or business question. These points are even more important because Lender is a memorandum opinion and has no precedential value.

Second, the Lender decision was narrow. This paper lists four reasons why the Lender structure may not be the panacea for every family office: some family offices don’t have as favorable facts as the Lender taxpayer; some family offices will be unable to fall under an exemption from securities registration; a family office’s profits interest may create other unintended tax consequences; and family investment partnerships will still be unable to deduct investment expenses. These reasons do not diminish the benefit of the Lender structure. Instead, these issues reflect significant concerns that every lawyer and family office executive needs to consider before jumping into the fray with their own Lender structure.

This paper proceeds as follows. Part II describes the sometimes-amorphous distinction between dealers, investors, and traders. It also provides a brief case study of private equity funds. Part III discusses the Lender family office structure and the Lender decision. Part IV discusses the implications of the case for future family offices and courts looking at the issue. Part V concludes.

II. BACKGROUND

A. Dealer, Trader, Investor

Lots of people buy, sell, and hold investments for many purposes and in many roles. Tax law separates these people into three categories: dealers, taxpayers like stockbrokers who help facilitate investments; investors, people with other jobs who invest their own money for personal gain; and traders, people in the profession of trading because they trade with more frequency and exploit short-term gains.11 Though not found in the Code, these labels provide a useful shorthand for the tax consequences of the activities of the taxpayer.12 This distinction is not pedagogical. As this section explores, whether a taxpayer is a dealer, trader,

or investor may have significant consequences on whether the person can deduct investment expenses incurred in generating the income.

1. **Dealer—A Merchant of Securities**

A dealer is a “a merchant of securities” who “buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom.”¹³ Essentially, the dealer “seek[s] to profit on the resale of those securities at marked up prices.”¹⁴ For example, a dealer is a business that, in its “ordinary course,” may offer interest rate or currency swaps to customers.¹⁵ As the next sub-section will show, some argue that private equity and venture capital funds are also “dealers” because they act as a party who buys securities on behalf of investors in hopes that the funds will sell the investments at a higher price in the future.¹⁶

There are three primary tax characteristics of this label. First, because dealers sell securities “to customers,” the securities in which they deal are not capital assets under section 1221(a)(1), and the dealers therefore need to pay tax at an ordinary income tax rate. Second, dealers need “to recognize gain or loss annually on a mark-to-market basis on their securities inventories and other securities not held for investment.”¹⁷ Third, dealers are in the trade or business of dealing securities and can deduct business expenses under section 162, which means that these losses can offset ordinary tax income and are not limited.

2. **Trader—Frequent, Regular, and Continuous Activity**

A trader manages a portfolio like a business with regularity and frequency. The term “refers to those individuals who actively buy and sell securities held over the short term for their own account, such as individuals who engage in online trading of stocks and securities.”¹⁸ Much like a dealer, the trader is engaged in a “trade or business” for his activities in buying and selling securities.

Traders, like dealers, can deduct business expenses under section 162 and often hold capital assets. Even so, because traders usually deal securities with great frequency—i.e., buy and sell the same security within a matter of days or weeks—they often need to recognize short-

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¹³ Oei, *supra* note 11, at 1017 (citing Treas. Reg. § 1.471-5).
¹⁴ *Id.*
¹⁵ *Id.* at 1064 (citing I.R.C. § 1.475).
¹⁶ *See infra* Part II.B.1.
¹⁸ Oei, *supra* note 11, at 1017-18.
term capital gains and pay tax at the higher, ordinary income tax rates. Additionally, traders can “mark to market” their securities under section 475(f) so that the trader can recognize unrealized income and losses from their trading every year.

Although the line between trader and investor can be blurry, Professor Oei distillated the difference into two essential traits. First, traders engage in activity that is “frequent, regular, and continuous enough to so qualify” as a trade or business.19 For example, one taxpayer in *Fuld v. Commissioner* made “about 249 sales of securities held for more than two years and about 98 sales of securities for two years or less” and “devoted an average of eight hours a day to studying texts and services, charting prices, conferring with his broker, attending meetings, and consulting corporate executives.”20 Likewise the taxpayer in *Mayer v. Commissioner* engaged in “substantial” activities where he “had over 1,100 executed sales and purchases in each of the years at issue.”21 But the taxpayer in *Chen v. Commissioner* was not a trader, in part because he made 94% of his trades “between February and April, and no transactions occurred in six of the other nine months of the tax year.”22

Second, Professor Oei said that traders must intend to make a short-term profit from the holding, buying, or selling the securities involved.23 In summarizing the distinction between a trader and an investor, the court in *Moller v. Commissioner* said that a trader must engage in activities “directed to short-term trading, not the long-term holding of investments, and income must be principally derived from the sale of securities rather than from dividends and interest paid on those securities.”24

The seminal case of *Commissioner v. Groetzinger*, which held that a professional gambler—whose sole wages derived from gambling—was engaged in a trade or business, highlights the short-term aspect of the trader distinction.25 The Supreme Court acknowledged that the tax-

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19 *Id.* at 1032.
20 *Id.* (quoting *Fuld v. Comm'r*, 139 F.2d 465, 485–89 (2d Cir. 1943)).
22 *Id.* (citing *Chen v. Comm'r*, T.C. Memo. 2004-132, 87 T.C.M. (CCH) 1388 (2004)).
23 *Id.* at 1035.
24 *Id.* at 1036 (citing *Moller v. Comm'r*, 721 F.2d 810, 813 (1983)).
25 480 U.S. 23 (1987). Although the Court did not directly adopt this dealer-trader-investor label, it implied that the distinction was relevant. *Id.* at 28 (noting that “the Court appears to have drawn a distinction between an active trader and an investor”).
pater was engaged in a trade or business, despite its unconventional-
ity. The Court rationalized the case as follows:

We accept the fact that to be engaged in a trade or business,
the taxpayer must be involved in the activity with continuity
and regularity and that the taxpayer’s primary purpose for en-
gaging in the activity must be for income or profit. A sporadic
activity, a hobby, or an amusement diversion does not
qualify.

The Court also cleared one misconception that taxpayers seemed to
struggle with after Justice Frankfurter’s concurring opinion in DuPont:
a trader need not trade to customers. Traders need not sell securities
on behalf or to another entity. What is important is that the taxpayer
“must be involved in the activity with continuity and regularity and that
the taxpayer’s primary purpose for engaging in the activity must be for
income or profit.” In other words, traders need not sell to anyone;
they may be engaged in a trade or business simply by buying and selling
securities using their own personal funds.

3. Investor—Infrequently Purchasing Securities Using Your Own
Money

Someone who buys and holds securities is not a dealer or a trader,
but an investor. An investor holds an investment “for investment or
speculation,” does not hold itself out as a merchant of securities, and
does not engage in trading activities with the regularity to make himself
a trader. For example, a lawyer who works forty-hours a week at a law
firm and spends one-hour a week “managing his portfolio” is likely an

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26 Id. at 33 (“If a taxpayer . . . devotes his full-time activity to gambling, and it is his
intended livelihood source, it would seem that basic concepts of fairness . . . demand that
his activity be regarded as a trade or business just as any other readily accepted activity
. . . .”).
27 Id. at 36.
28 Id. at 29 (citing Deputy v. Du Pont, 308 U.S. 488, 499 (1940) (Frankfurter, J.,
concurring)); see also F. Ladson Boyle, What Is A Trade or Business?, 39 TAX LAW. 737,
762 (1986) (noting that in the pre-Groetzinger context, “the goods or services test of
Justice Frankfurter is the hardest to justify” because although it is “reasonably objective,
in operation, it has little effect and can produce unfair results”).
29 Groetzinger, 480 U.S. at 34 (“We are not satisfied that the Frankfurter gloss
would add any helpful dimension to the resolution of cases such as this one, or that it
provides a ‘sensible test. . . .’ It might assist now and then, when the answer is obvious
and positive, but it surely is capable of breeding litigation over the meaning of ‘goods,’
the meaning of ‘services,’ or the meaning of ‘holding one’s self out.’ And we suspect
that—apart from gambling—almost every activity would satisfy the gloss.”).
30 Id. at 35.
31 Treas. Reg. § 1.471-5(c).
investor when he manages his portfolio. Unlike dealers and traders, investors do not have a trade or business.

Investors’ tax characteristics are both better and worse of that of a dealer or trader. First, investors hold capital assets because the investor does not sell “to customers.” Because section 1221 works as an exclusionary rule (saying a capital asset is any asset not explicitly listed in the statute) and because none of the exceptions under the rule apply, investors will pay income tax at a preferential capital gains tax rate. Second, although the tax treatment of income is more beneficial to investors, investors have a worse tax treatment for losses. Individuals and corporations are limited in the investment losses that they can deduct. Third, investors are typically not in the trade or business of investing securities and thus cannot deduct business expenses under section 162. Investors can deduct expenses under section 212, but the TCJA limited the ability of investors to deduct these expenses until 2026.

The prototypical investor is the taxpayer in Higgins v. Commissioner, a case that held that someone managing investments for his own family does not have a trade or business. The Court noted that the investor had “extensive investments in real estate, bonds and stocks, devoted a considerable portion of his time to the oversight of his interests and hired others to assist him in offices rented for that purpose.” The taxpayer argued that his actions were more like a trader—that “‘elements of continuity, constant repetition, regularity and extent’ differentiate his activities from the occasional like actions of the small investor.” The Court rejected his argument: “[n]o matter how large the estate or how continuous or extended the work required may be,” an investor does not have a trade or business when he “merely kept records and collected interest and dividends from his securities, through managerial attention for his investments.”

33 See I.R.C. § 1211.
35 312 U.S. 212, 216-17 (1941). The taxpayer in Synder also exemplifies a typical investor. The taxpayer in that case was a “salaried secretary” who made a series of margin trades and tried to argue that he was in a trade or business. See Snyder v. Comm’r, 295 U.S. 134, 139 (1935). The Court rejected his argument, noting that he did not “make a living in buying and selling securities” and only tried to take “advantage of the turns of the market” by increasing his margin “as great an extent as the margin of his account permitted.” Id. In other words, the taxpayer in Synder was not a trader because he did not engage in enough regular activity to gain the trader label.
36 Higgins, 312 U.S. at 218.
37 Id. at 213.
38 Id. at 215.
39 Id. at 218.
The Court reaffirmed its position in *Whipple*, in which it denied a taxpayer from taking certain business losses because the taxpayer was not engaged in a trade or business.40 There, the Court explained that devoting one’s time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation’s business as distinguished from the trade or business of the taxpayer himself. *When the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business* since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation.41

Even though the Supreme Court decided *Higgins* over eighty years ago and before the enactment of section 212, the Court highlighted its significance in *Groetzinger*. There, the Court did not overrule or cut back on the Court’s holding in *Higgins* when we conclude that if one’s gambling activity is pursued full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business within the meaning of the statutes with which we are here concerned.42

Put another way, *Higgins* is still and has always been good law. Someone managing investments for their personal account or their family will not be engaged in a trade or business unless that taxpayer’s activity rises to the level of a trader.

But some lawyers seem to think that this analysis changes for C corporations because there is a *presumption* that a C corporation has a trade or business. More precisely, lawyers and accountants point to Revenue Ruling 78-195, in which the IRS said that a corporation “that was formed for the express purpose of investing in real property purchased a tract of unimproved, non-income-producing real property, which it held for two years and sold without having made any substantial improve-

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41 *Id. at 202* (emphasis added).
ment” was eligible to take a section 162 deduction for its expenses.\textsuperscript{43} The ruling stated that the “the corporation did not make any significant efforts to sell the property and did not engage in any other transactions in real or personal property or in other commercial activities.”\textsuperscript{44} In other words, the corporation likely was not a dealer or trader, but the IRS still said that the entity was in a trade or business; ergo, tax practitioners rationalize that the trade or business analysis must differ for C corporations.

But the problem with this logic is that it does not come from any statute or case. Instead, the main support for this argument comes from a Revenue Ruling that was scant on analysis and rationale. It is likely that a court will not defer to this ruling as it lacks any “power to persuade” given its inconsistency with the general case law regarding trade or business.\textsuperscript{45} Additionally, whatever presumption existed in pre-TCJA (when the corporate tax rate was 35\%) likely does not exist today (when the corporate tax rate is 21\%). If a corporation reinvests its profits, it is possible that a taxpayer will pay less in overall tax in a corporate structure after accounting for the time value of money than the taxpayer would pay holding an investment in his or her own name. It would simply be too easy of a work around if taxpayers could incorporate a family office and turn otherwise section 212 expenses into section 162 expenses. Instead, it is far more likely that the dealer-trader-investor analysis does not differ depending on the entity which the taxpayer uses.

B. Private Equity Funds

Private equity funds offer an interesting analogy to family office structure described in \textit{Lender}. Because the \textit{Lender} court spent much of the opinion comparing the family office to a typical investment fund,\textsuperscript{46} a brief detour will enlighten the discussion of the \textit{Lender} case.

Private equity funds “make investments in portfolio companies, usually in connection with increasing the leverage of those compa-
nies.” These funds usually buy the entire company (i.e., “all or nearly all of the portfolio company’s outstanding stock”) and usually hold their investments for over a year. Funds are typically structured as Limited Liability Partnerships where wealthy and tax-exempt investors provide nearly all of the capital and are the limited partners, private equity fund managers provide little capital and invest as general partners, and an affiliated management company provides management services to the fund in exchange for carried interest. Professor Polsky has created a chart that shows a common private equity legal structure.

1. Trade or Business

Some commentators have argued that private equity funds are engaged in a trade or business. Steven Rosenthal has argued these funds are “corporate developers” because they seek to “pursue [...] and acquire [...] multiple underperforming companies to turn them around and sell them for a profit.” These funds are not traders because their activity is not “continuous, regular and substantial” (the lifecycle of the private equity fund will likely be over several years, not days). Instead,

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48 Id.
50 Id.
52 See supra Part II.A.
Rosenthal argues that private equity funds are like “securities dealers” who “profit from selling securities from their inventory, intermediating between buyers and sellers.”

Like dealers, the private equity fund buys securities and seeks to sell them for a far greater price years later “at a profit, which, under the circumstances, differs from a normal investor’s return.”

Of course, this label is not perfect. First, private equity funds do not have "customers" or "inventory" in the traditional section 1221 sense. Although Rosenthal argues that private equity funds should be part of this definition under the original intent of section 1221,55 such a distinction seems textually difficult. On the other hand, for the trade or business test, the “to customers” distinction is not relevant after Groetzinger.57 Second, unlike most brokers, private equity funds invest alongside its limited partners. The private equity fund not only receives compensation for the services it provides, but also receives a return as an investor. Third, many private equity funds argue that they are not engaged in a trade or business. Such a categorization is necessary to prevent adverse effects to foreign and tax-exempt investors.58 Although this categorization does not affect the trade or business analysis, it is likely that parties structure their affairs in such a way to weaken the case that the fund has a trade or business.

But even with this incentive, two courts have concluded that a private equity fund is engaged in a trade or business. First, the Tax Court, in Dagres v. Commissioner, held that a general partner of a venture capital fund,59 and by connection the member who managed it, was engaged in a trade or business.60 The court explained that the general partner “did not vend companies or corporate stock to customers as in-

53 Rosenthal, supra note 51, at 1466.
54 Id. at 1467.
55 Id. at 1469.
56 Valerie M. Hughes, Flip This Company, but Don’t Leave Its Pensioners Out in the Cold: Sun Capital as a Call to Action to Change Taxation of Private Equity Funds, 92 N.C. L. Rev. 1322, 1366 (2014) (“However, even if private equity funds engage in a ‘trade or business,’ they must still hold property ‘primarily for sale to customers’ in order to be subject to ordinary income rates.”).
58 Gregg D. Polsky, The Untold Story of Sun Capital: Disguised Dividends, 142 Tax Notes 556, 556 (Feb. 3, 2014) (“If private equity funds were determined to be in a trade or business for tax purposes as a result of the monitoring fee/offset structure, foreign investors might have to recognize effectively connected income, and tax-exempt investors might have to recognize unrelated business taxable income.”).
59 A venture capital fund is typically described as a subset of private equity, except that these funds invest in start-up companies and only take a minority stake in those companies. See Polsky, supra note 47, at 615 n.1.
60 136 T.C. 263, 264 (2011).
ventory but nevertheless, like dealers, did earn compensation (in their case, fees and a significant profits interest) for the services they provided in managing and directing the investment of the venture capital. . . .” The court explained that “[l]ike a stockbroker or a financial planner, the General Partner L.L.C.s received compensation for services they rendered to clients.”

The court also dismissed the IRS’s argument that the general partner was not engaged in a trade or business because it had only a one percent interest in the venture capital fund; instead, the tax court highlighted that the general partner had a carried interest on twenty percent of the profits that the venture capital fund made. The court said that the 99-percent investors were not looking for a 1-percent co-investor; they were looking for someone in the business of managing venture capital funds, who could locate attractive investment targets, investigate those companies, negotiate investment terms, help the companies to thrive, design exit strategies, liquidate the holdings, and achieve an attractive return for them; and the General Partner L.L.C. conducted that business.

A second case is Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund, in which the First Circuit held that a private equity fund was engaged in a trade or business, although in the ERISA context where courts look to tax trade or business cases. The appellants were two private equity funds that received investment from limited partners and management services from a general partner that received a standard two-and-twenty fee structure (as discussed in the next sub-section) as compensation for the services it provided. The private equity funds bought a trucking company and, after the trucking company declared for bankruptcy, argued that they should not be liable for the company’s pension obligations. Because only a parent company engaged in a trade or business can be liable for a subsidiary’s pension obligations under 29 U.S.C. § 1301, the private equity funds argued that they were not liable because “they cannot be ‘trades or businesses’” under Supreme Court tax cases like Higgins.

The First Circuit rejected the private equity funds argument and instead adopted an “investment plus” approach advocated for by the Pension Benefit Guaranty Corporation. The court noted that the stan-

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61 Id. at 284.
62 Id. at 284–85.
63 Id. at 285–86.
64 724 F.3d 129 (1st Cir. 2013).
65 Id. at 144.
66 Id. at 141.
dard was “a very fact-specific approach” in which no factor “is dispositive in and of itself.”67 The court went out of its way to say that, even though “trade or business” may be applied differently in section 162 than it is used in ERISA, the investment plus test dovetails with other tax trade or business cases like Groetzinger. Although the court did not precisely label what constituted a “plus” activity and what did not, it was sufficiently convinced that one of the private equity funds satisfied the plus standard.68 Several factors were important to this factual finding:

- In its partnership agreements and private placement memorandums, the funds stated that “a ‘principal purpose’ of the partnership is the ‘manag[ement] and supervisi[on]’ of its investments.”
- The General Partner had “exclusive and wide-ranging management authority” about “hiring, terminating, and compensating agents and employees of the [funds].”
- The private placement memorandums noted that the General Partners “work to reduce costs, [and] improve margins” and monitor investments of the Fund.
- The overall goal of the investment fund was to “sell[ ] the portfolio company for a profit” in less than five years.69

Some have argued that the First Circuit’s analysis was lacking. Rosenthal argued that some of the points that the court emphasized “were slender reeds to distinguish a trade or business and, in [his] view, confused the Whipple inquiry.”70 Instead, he argued that the court should have adopted a new test that falls in line with his corporate developer model.71 Others have argued that “[b]y failing to define the ‘plus’ in its ‘investment plus’ standard, the First Circuit also avoided making a precedent that other courts could easily apply.”72 Some have questioned whether labeling a private equity fund a trade or business is good from a policy perspective,73 but the label is likely here to stay for some funds.

67 Id.
68 Id. at 133.
69 Id. at 142.
70 Rosenthal, supra note 51, at 1466.
71 Id. at 1466-67.
72 Hughes, supra note 56, at 1358.
73 See Sarah Sutton Osborne, Comment, Carried Away: Sun Capital, Politics, and the Potential for A New Spin on “Trade or Business” in Private Equity, 45 COMB. L. REV. 595, 637 (2015) (“If tax analysts are able to analogize private equity funds with real estate developers, do we allow the analogy to dictate regulatory change despite the significant effect on the economy? While political forces may successfully roust carried interests from their current capital gains treatment, private contracting and market forces will likely redistribute funds’ returns at the expense of the government and economy. Accordingly, regulators must consider what policy objective would such a shift in carried interest
In the end, *Sun Capital* is more remarkable because it created a new way to look at the traditional trade or business test. As Part IV explores, applying this new type of test to the family office context may offer a more doctrinally consistent way to look at the trade or business characterization than the traditional trader-dealer-investor test.

2. Compensation

Private equity funds are often compensated in two ways, by a management fee and carried interest. Top investment funds often charge an investment fee of two percent of assets under management. Funds get this fee every year to ensure that they can keep the lights running in the investment firm. But private equity funds often receive the bulk of their compensation from carried interest, through which a fund will receive some of the profits that an investment vehicle makes (often twenty percent) after the vehicle makes more than a hurdle rate (often eight percent).

There may be a time-delay on when the investment funds make the profit which could artificially inflate the amount of carried interest that the investment fund earns. To protect the investor, funds often have taxation ultimately achieve?”); cf. Victor Fleischer, *Sun Capital Court Ruling Threatens Structure of Private Equity*, N.Y. TIMES DEALBOOK (Aug. 1, 2013, 12:28 PM), https://dealbook.nytimes.com/2013/08/01/sun-capital-court-ruling-threatens-private-equity-structure/ (“No one disputes that the general partner (or its affiliated management company) often gets highly involved with the fund’s portfolio companies. In *Sun Capital*, for example, the management company weighed in on the portfolio company’s personnel decisions, capital spending and possible acquisitions. The critical question is whether the general partner’s activities can be attributed ‘downward’ to the fund – that is, from the partner to the partnership.”).  

74 *Cf.* Mark J. DeLuca, *It's Not Always Sunny in Private Equity: Analysis and Impact of the First Circuit’s Sun Capital Decision*, 46 ARIZ. ST. L.J. 1441, 1469 (2014) (quoting a Treasury official who said that the decision gave the agency the “opportunity to reassess what ‘trade or business’ means” for tax purposes).

75 A third way in which private equity funds receive compensation are via fees paid from portfolio companies to the general partner. But these so-called “monitoring fees” are not relevant to the family office structure. For a discussion of monitoring fees more generally, see Gregg D. Polsky, *Private Equity Monitoring Fees as Dividends: Collateral Impact*, 143 TAX NOTES 1053 (June 2, 2014).


77 Fleischer, *supra* note 76, at 22. “The profits interest is what gives fund managers upside potential: If the fund does well, the managers share in the treasure. If the fund does badly, however, the manager can walk away. Any proceeds remaining at liquidation would be distributed to the original investors, who hold the capital interests in the partnership.” *Id.* at 3.
three protections in place. Still, some private equity funds engage in tricks to maximize the fund return, possibly to the detriment of investors. See id. at 22 (noting that private equity funds charge a fund-favorable preferable return whereby the “profits are then allocated disproportionately to the GP” after the fund crosses the hurdle rate “until the GP’s compensation catches up to the point where it would have been had the GP received twenty percent of the profits from the first dollar.”). On the other hand, some private equity funds arguably help investors who would have otherwise been limited by the section 67(a) limit on section 212 expenses. See Gregg D. Polsky, A Compendium of Private Equity Tax Games, 146 TAX NOTES 615 (Feb. 2, 2015) (discussing strategies of the private equity fund, including monitoring fees and monitoring fee deductions, that arguably help limited partners).

78 Still, some private equity funds engage in tricks to maximize the fund return, possibly to the detriment of investors. See id. at 22 (noting that private equity funds charge a fund-favorable preferable return whereby the “profits are then allocated disproportionately to the GP” after the fund crosses the hurdle rate “until the GP’s compensation catches up to the point where it would have been had the GP received twenty percent of the profits from the first dollar.”). On the other hand, some private equity funds arguably help investors who would have otherwise been limited by the section 67(a) limit on section 212 expenses. See Gregg D. Polsky, A Compendium of Private Equity Tax Games, 146 TAX NOTES 615 (Feb. 2, 2015) (discussing strategies of the private equity fund, including monitoring fees and monitoring fee deductions, that arguably help limited partners).

79 See Andrew W. Needham, U.S. Income, 736 TAX MGMT. PORTFOLIOS (BNA), at III.C.

80 Id.

81 Id.

82 Id.
that limited partners strike with the funds’ general partner. The rate that the fund charges and the protections that limited partners demand reflect the bargaining power and the risk appetite of funds and investors. The compensation hinges on the investor and fund negotiating over each term. Without this negotiation, it is likely that a carried interest fee may not resemble a typical fee of a private equity fund. In the family office context, a future court may be more skeptical that a deal was at arm’s length if the parties did not negotiate over the terms of the carry.

3. Disguised Fee for Services

But it is important to step back to highlight why the profits interest has become so ubiquitous in the private equity: the preferential capital gain tax rate. Much has been said about the policy arguments for and against this preferential tax rate and this paper will not reiterate that discussion. This preferential capital gain rate is also essential for the family office structure. If the family office paid tax at an ordinary rate for the income on the services that it performs for the investment partnerships, it is far more likely that family offices would not be as popular as they are now. Put differently, few investors would pay tax on gains at an ordinary tax rate and deduct investment expenses if they could pay tax on gains at a preferential rate.

Private equity funds pay tax at a preferential rate when they receive compensation by a profits interest and hold that profits interest for at least three years. A taxpayer receiving a profits interest would not be taxed when the taxpayer receives the interest in the partnership, but would be taxed when the taxpayer disposes of that interest. However, that is not the only way to view the transaction. The IRS may instead argue that the profits interest is in substance a fee for services that the partner provides the partnership. Section 707(a)(2)(A) allows the IRS to recharacterize a profits interest into a disguised fee for services that would be immediately taxable at ordinary rates when the partner receives that interest.

In 2015, the government released proposed regulations under section 707(a)(2)(A) which maintained that the IRS would apply a facts-and-circumstances test to evaluate whether a profits interest would be respected. Although these regulations have not been finalized, they offer the most authoritative view as to when a profits interest will be

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83 See id. at III.A.
84 Id.
85 See Fleischer, supra note 76, at 3-6.
86 See I.R.C. § 1061.
recharacterized as compensation for services. The regulations listed six factors for the test, with the most important factor being whether the arrangement has “significant entrepreneurial risk,”88 which the taxpayer must show with clear and convincing evidence.89 A profits interest that lacks significant entrepreneurial risk will likely not be respected as a profits interest and will instead be recharacterized as a payment for services. The regulations list five arrangements that lack significant entrepreneurial risk:

(i) Capped allocations of partnership income if the cap is reasonably expected to apply in most years;
(ii) An allocation for one or more years under which the service provider’s share of income is reasonably certain;
(iii) An allocation of gross income;
(iv) An allocation (under a formula or otherwise) that is predominantly fixed in amount, is reasonably determinable under all the facts and circumstances, or is designed to assure that sufficient net profits are highly likely to be available to make the allocation to the service provider (e.g. if the partnership agreement provides for an allocation of net profits from specific transactions or accounting periods and this allocation does not depend on the long-term future success of the enterprise); or
(v) An arrangement in which a service provider waives its right to receive payment for the future performance of services in a manner that is non-binding or fails to timely notify the partnership and its partners of the waiver and its terms.90

Example five to the proposed regulations expounds on this point in the context of private equity funds. The example provides that

A is a general partner in newly-formed partnership ABC, an investment fund. A is responsible for providing management services to ABC, but has delegated that management function to M, a company controlled by A. Funds that are comparable to ABC commonly require the general partner to contribute capital in an amount equal to one percent of the capital contributed by the limited partners, provide the general partner with an interest in 20 percent of future partnership net income and gains as measured over the life of the fund, and pay the

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89 Id.
90 Id. at 43658-59.
fund manager annually an amount equal to two percent of capital committed by the partners.\textsuperscript{91}

The example states that A’s interest in the net income of the partnership has significant entrepreneurial risk because A has a clawback obligation for its profits interest, it is neither “highly likely to be available nor reasonably determinable” that A would receive an allocation of net income, and the present value of the interest equals the amount of capital that A contributed to the partnership.\textsuperscript{92} Because there is a significant risk that A’s profits interest would not be worth anything if ABC did not make any money, A’s profit interest will be respected and will not be a disguised fee for services.

One hurdle to this strategy is that private equity funds try to minimize the risk that they will not be compensated. Funds can make the profits interest as a percentage of revenue, or virtually guarantee that the partner may be allocated a profits interest by way of a priority allocation, whereby a partner is allocated a percentage of the gain or revenue equal to a certain amount before any other partner receives an income allocation.\textsuperscript{93} But there is a risk that implementing these strategies may eliminate significant entrepreneurial risk that the profits interest will not come to fruition. Private equity lawyers seek to create an allocation that minimizes risk and ensures that the gain will be taxed at preferential capital gains rates.

In summary, the disguised fees for services proposed regulations show that the term “profits interest” does not have a uniform meaning. Such an interest may not have significant entrepreneurial risk because the fund has a priority allocation or because the profits interest is based on a percentage of gross income. And because family offices need to be profitable in order to satisfy the trade or business characterization, they may have the same incentive as the private equity fund to maximize the likelihood of being allocated a portion of the gain of the partnership. As the \textit{Lender} case shows, family offices may seek to implement profits interest as a percentage of trading costs and without clawback provisions.

Before discussing how the Lender family used the profits interest, a brief detour is necessary to explain why and how the family created the family office structure.

\textsuperscript{92} Id.
\textsuperscript{93} Id. at 43659 (Example 3).
III. THE LENDER CASE

A. Lender Family

The Lender family story begins with the patriarch of the family—Harry—who, in 1929, opened a bagel shop in New Haven, Connecticut.94 The shop was very popular on the weekend, but was dead during the week.95 As a result, Harry needed to bake the bagels close to the weekend because bagels staled quickly. This “uneven timed demand” create a huge amount of inefficiency and lead to poor employee morale for those people who did not want to spend their entire weekend at a bagel shop. To solve this demand, Harry froze bagels, allowing workers to make the bagels earlier in the week without getting stale before the weekend rush.96

Harry’s sons, Marvin and Murry, used this revolutionary idea to get bagels onto American supermarket shelves.97 Without Marvin and Murry, bagels would not be as widely known and loved as they are today.98 Although the bagels’ taste may have been lacking, some have argued that “Lender’s innovated by finding a way to compromise on quality and reap huge gains in other spheres.”99 By offering an inferior product that could be frozen, Lender’s marketed a new product to millions of Americans who would otherwise not have discovered the product.100 Marvin and Murry sold Lender’s to Kraft in 1984 for a reported $90 million dollars,101 worth roughly $220 million in 2019 dollars.102 The Lenders used their newfound wealth to diversify and make other non-bagel-related investments.

1. Need for a Family Office Structure

In 1987, soon after selling Lender’s, the family set up Lender Management LLC (Lender Management), which was the entity under dis-

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95 Id.
96 Id.
97 Id.
99 Yglesias, supra note 94.
100 Id.
pute in the case. Lender Management facilitated investment and helped to grow the family fortune.\textsuperscript{103} Lender Management was a partnership for tax purposes.\textsuperscript{104} Besides the other benefits of pooling investments such as lower fees and greater access to private investment vehicles,\textsuperscript{105} the Lender family implemented this structure in part because there were a lot of Lenders.\textsuperscript{106} At the tax year in issue, four generations of Lenders participated in the investment structure: the G1 generation (Harry’s wife); G2 generation (including Marvin, Murry, and their spouses); the G3 generation (including Keith and Carl); and the G4 generation (ten of Harry’s great-grandchildren). And the members in the G3 generation, except Keith, had careers independent of Lender Management.\textsuperscript{107}

![Family Tree Diagram]

Although the family pooled their money together, a lot of things inhibited the Lender Management team from acting as one cohesive voice. First, the Tax Court recognized there were “numerous divorces among Lender family members,” including a divorce from Murry and his ex-wife which depleted the Murry side of the Family Office.\textsuperscript{108} Second, one member of the G2 generation—Harry’s daughter—decided not to invest within the family structure.\textsuperscript{109} Third, some of the family

\textsuperscript{103} Lender Mgmt., LLC v. Comm'r, T.C. Memo. 2017-246, 114 T.C.M. (CCH) 638 at *3 (2017).
\textsuperscript{104} Id. at *1.
\textsuperscript{105} See Aghdami & Harris, supra note 5 (“A family office can create economies of scale for a family, reduce the cost of services, open investment opportunities, help guarantee privacy, and allow for greater family control over service providers.”).
\textsuperscript{106} Lender, 114 T.C.M. (CCH) at *2-4.
\textsuperscript{107} Id. at *1.
\textsuperscript{108} Id. at *2.
\textsuperscript{109} Id. at *1.
members “were in such conflict with others that they refused to attend the same business meetings.” Fourth, the Lenders lived in many different states and countries.

In 2005, Lender Management tried to assuage the concerns of some family members and “engaged a hedge fund specialist to help it restructure its affairs and its management portfolio using a hedge fund, or ‘fund of funds,’ manager model.” After the restructuring, “Lender Management divided its managed portfolio into the three investment LLCs,” which were split between asset classes: Murry & Marvin Lender Investments LLC (M&M), which invested in private equity and other alternative asset classes; Lenco Investments LLC (Lenco), which invested in hedge funds; and Lotis Equity LLC (Lotis), which invested in public-company stocks. Each investment LLC was in turn owned by Lender Management and other entities (trusts and other family investment partnerships) that Lender family members controlled. Lender Management was owned by two trusts. To illustrate the ownership diagram, below is a chart that shows the direct ownership of M&M in 2012:

![Ownership Diagram]

2. Activities of the Family Office

Lender Management had two functions. First, it provided investment advice to members of the Lender family. The Lender family members had no obligation to keep money within the family office structure. Instead, the office said that its “investment choices and related activities were driven by the needs of clients.” And because the Lender family “did not act collectively or with a single mindset,” the family office “provided investment advisory services and managed investments for each of

110 Id. at *12.
111 Id. at *1.
112 Id. at *3.
113 Id.
114 Id.
115 Id. at *2.
116 Id. at *12.
its clients individually, regardless of the clients' relationship to each other or to the managing member of Lender Management. If any investor grew dissatisfied with the family office or otherwise needed capital for other uses, that investor could withdraw their money from the investment LLCs at any point, subject to liquidity and approval from the family office.

Second, Lender Management provided management services to the investment LLCs—M&M, Lenco, and Lotis. Lender Management had “the exclusive rights to direct the business and affairs of” each investment LLC. The entity also “managed the downstream entities in which M&M held a controlling interest,” which constituted about 12-15% of M&M’s portfolio.

Keith Lender, part of the G3 generation, was the Chief Investment Officer for Lender Management. He worked about fifty hours a week, communicated with his family members (whom he called “clients”) about their investments, reviewed over “150 private equity and hedge fund proposals per year on behalf of the investment LLCs,” and met with various investors who sought capital from the Investment LLCs. He also tried to meet once a year with each client about their investment goals in the family office structure. Notably, however, Lender Management was not a trader because Keith did make individual investment decisions about what asset to buy or sell, nor was it a dealer that made profit by reselling investments above-cost to clients.

Including Keith, Lender Management employed five individuals and had a total payroll of over $390,000 in 2012. The employees’ “main objective was to earn the highest possible return on assets under management.” The employees managed the cash flow of the operation—including for capital calls from private equity firms—and provided financial information to the family members. Lender Management outsourced many of its accounting and investment advisory responsibilities to Pathstone Family Office, LLC. Although Lender Management had ultimate authority, Pathstone prepared quar-

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117 Id.
118 Id. at *4, *12.
119 Id. at *3.
120 Id.
121 Id. at *5.
122 Id.
123 See id. at *4-5.
124 Id. at *4.
125 Id.
126 Id. at *6.
127 Id. *6-7.
terly financial reports for the LLCs and provided due diligence for prospective investments.128

3. Carried Interest

Part of the 2005 shift to the “funds-of-fund” model was a shift in how Lender Management was compensated. In exchange for the value it gave its members, Lender Management received “Class A interests” from the investment LLCs, similar to the carried interest described in the previous section.129 But Lender received no payments from the family members whose money it advised; instead, its sole method of compensation, and the only way it received money to pay its operating expenses, was through the carried interest and management fees that it received. Lender Management argued this compensation meant that the office shifted from a cost-based to a “profit-based” office model.130

But the compensation of Lender Management was not like the investment funds it modeled its business after. From M&M and Lenco, Lender Management received carried interest “of 2.5% of net asset value, plus 25% of the increase in net asset value, annually.”131 From Lotis, it received carried interest of “2% of net asset value annually, plus 5% of net trading profits.”132 These values vastly exceed the typical “2 and 20” fee charged by investment funds. Part IV explores whether this excessive fee compensation was really an investor return and whether the fee was in substance a disguised fee for services because the arrangement lacked significant entrepreneurial risk.

B. The Tax Court Decision

Judge Kerrigan concisely summed up the issue in Lender: “The sole issue for consideration is whether Lender Management carried on a trade or business within the meaning of section 162. . . .”133 After discussing the factual, procedural, and preliminary evidentiary issues, the Tax Court began its opinion by discussing the differences in deducting investment expenses under section 162, whereby a taxpayer engaged in a trade or business can take above-the-line deductions, and section 212, where a taxpayer is only engaged in making income and can only take below-the-line deductions that may be limited.134 For the tax years at

\[\text{128 Id.}\]
\[\text{129 Id. at *4.}\]
\[\text{130 Id. at *3.}\]
\[\text{131 Id. at *4.}\]
\[\text{132 Id.}\]
\[\text{133 Id. at *1.}\]
\[\text{134 Id. at *8.}\]
issue, Lender Management claimed section 162 expenses of over $1 million related to the family office’s management expenses.\textsuperscript{135}

The Tax Court noted “[t]he Code does not define the term ‘trade or business.’”\textsuperscript{136} Instead, it used the facts-and-circumstances Groetzinger test: the taxpayer is engaged in a trade or business when it acted “with continuity and regularity” and when “the taxpayer’s primary purpose for engaging in the activity” was a desire “for income or profit.”\textsuperscript{137} The Tax Court also cited Whipple and Higgins for the proposition that managing your own investments is not enough to establish a trade or business.\textsuperscript{138}

But the court did not use the typical dealer-trader-investor label to distinguish whether a taxpayer has a trade or business. Instead, it said that a trade or business may have been established if the taxpayer receives “compensation other than the normal investor’s return,” including “services provided to others.”\textsuperscript{139} The court explained that “[t]he trade-or-business designation may apply even though the taxpayer invests his or her own funds alongside those that are managed for others, provided the facts otherwise support the conclusion that the taxpayer is actively engaged in providing services to others and is not just a passive investor.”\textsuperscript{140}

In the court’s view, “Lender Management provided investment advisory and financial planning services” to family members that “were comparable to the services that hedge fund managers provide.”\textsuperscript{141} The court mentioned that the taxpayer managed cash flow for the family’s investments, provided bookkeeping functions, and selected investment managers to manage the family wealth.\textsuperscript{142} And by providing these services, the family office “was entitled to profits interests as compensation for its services to its clients to the extent that it successfully managed its clients’ investments.”\textsuperscript{143}

Based on the services the taxpayer provided and the profits interest it received, the court concluded that “Lender Management’s activities were providing investment management services, which it primarily provided to and for the benefit of clients other than itself,” similar to the Venture Capitalist in Dagres who invested money on behalf of his cli-

\begin{footnotes}
\item[135] Id. at *7.
\item[136] Id. at *8.
\item[137] Id. (citing Comm’r v. Groetzinger, 480 U.S. 23, 35 (1987)).
\item[138] Id.
\item[139] Id. at *9.
\item[140] Id.
\item[141] Id. at *9-10.
\item[142] Id. at *10.
\item[143] Id.
\end{footnotes}
ents.144 Still, the Tax Court explained that the transactions between the Lender family members were “subject to heightened scrutiny” because of the interwoven family nature of the business.145 But even under this more stringent test, the court found that the taxpayer had established a “bona fide business relationship” with the family members for three reasons.146

First, the family members were not required, nor was there any obligation or expectation, to keep their money in the investment LLCs. Lender Management needed to approve any “complete withdrawal”147 from the investment funds, but the Tax Court was satisfied that the taxpayer would have acted reasonably.148 Second, the family members “were geographically dispersed, many did not know each other, and some were in such conflict with others that they refused to attend the same business meetings.”149 Lender Management needed to tailor its investment expertise to each family member and could not provide blanket advice to everyone. Third, the court explained that many family members generated employment income besides whatever investment income they received from the investment LLCs.150 The Tax Court’s reasoning on this point was rather circular, as it explained that Keith generated employment income from Lender Management, which only received its income because it invested the family fortune.151

IV. IMPLICATIONS OF LENDER

The Lender decision was undoubtably a positive decision for family offices looking to deduct investment expenses. Still, the decision was not as positive as one may expect. This section expands on two points why taxpayers may not benefit from the Lender decision as much as they would have hoped: the court’s rationale was not persuasive on some points and the holding is narrow relative to the universe of family offices.

144 Id. at *11.
145 Id.
146 Id.
147 Id. at *12.
148 Id.
149 Id.
150 Id.
151 Id. The Tax Court also stressed there were “no applicable attribution rules that would require” Lender Management to be “owning all of the interests in the investment LLCs.” Id. at *13. Lender Management was owned by trusts operated to benefit Keith and Murry, both of whom did not own most of the interests in the investment LLCs.
A. Critique of Lender

1. Profits Interest

One of the key facts in *Lender* was that the family office “was entitled to profits interests as compensation for its services to its clients to the extent that it successfully managed its clients’ investments.”152 In other words, the court took the profits interest as a sign that the family office had a bona fide business relationship with the investment partnerships. But as Part II discussed, there are many ways in which a fund may structure a profits interest, including in ways that lack significant entrepreneurial risk. If a partner receives a profits interest that is virtually certain to create a positive profits allocation from the partnership, that partner in substance received a disguised fee for services that, if recharacterized, would be taxable at an ordinary tax rate instead of at a preferential capital gains tax rate. In contrast, if a partner receives a profits interest subject to a clawback provision (i.e., the partner only gets a profits allocation if the partnership makes money), the profits interest will be respected as such.

Although not discussed in *Lender*, it is likely that the management fee that Lender Management charged the investment partnerships did not have significant entrepreneurial risk. To recap, here is a chart of the fees that the family office charged relative to the fee that private equity funds normally charge:

<table>
<thead>
<tr>
<th>Compensation Type</th>
<th>Typical PE Fund</th>
<th>M&amp;M</th>
<th>Lenco</th>
<th>Lotis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Fee</td>
<td>2% of net asset value (“NAV”)</td>
<td>2.5% of NAV</td>
<td>2.5% of NAV</td>
<td>2% of NAV</td>
</tr>
<tr>
<td>Carried Interest</td>
<td>20% profits</td>
<td>25% of increase in NAV</td>
<td>25% of increase in NAV</td>
<td>5% of net trading profits</td>
</tr>
<tr>
<td>Limitations on Carry</td>
<td>Only get carry after 8% hurdle</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Clawback</td>
<td>If subsequent loss within 3 years</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

We do not know enough about the operations of Lender Management to know for sure, but one can speculate that a fee based on changes in “net asset value” or as a percentage of trading profits likely does not

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152 *Id. at* *10.
have significant entrepreneurial risk under the test described in disguised fee proposed regulations. These allocations seem to be ones that are “reasonably determinable” or “designed to assure that sufficient net profits are highly likely to be available” to make the allocation. Although not raised by the IRS, this paper speculates that these profits interests should have been considered disguised fees for services. If the Tax Court did make that determination, Lender Management would have needed to pay ordinary income tax on the profits interest that it received for providing services to the investment partnerships.

The harder question is how a profits interest that lacks significant entrepreneurial risk changes the trade or business analysis. The Lender court did not address this point and it is hard to speculate how a future court will view this argument. Because the significant entrepreneurial risk test operates for a different purpose, a court may find that the analysis does not change the trade or business test because a profits interest may still show that the family office acted like a normal investment adviser or private equity fund. And because some private equity funds draft carried interest provisions that have priority allocations and do not impose a clawback obligation on the general partner, there is an argument that a profits interest that lacks significant entrepreneurial risk may show that the arrangement had a business relationship.

But a more straightforward approach is that a profits interest that lacks significant entrepreneurial risk should not be a positive factor in determining whether the family office is a trade or business. For example, the Lender Management profits interest depends on “net asset value,” which seems to be virtually certain to create some profit allocation. Because the family office could receive an allocation even if the investment partnership lost money over the life of the fund or did not achieve a sufficient return over a hurdle rate, the family office could theoretically receive a profits interest that approximated an investor’s normal rate of return. The Whipple Court acknowledged that an investor likely does not have a trade or business when its “only return is that of an investor.” Because a family office receives a return similar to that of an investor when it receives a profits interest that lacks significant entrepreneurial risk, this type of profits interest should not be a positive factor that a family office has a trade or business.

Future courts should carefully consider whether the profits interest has significant entrepreneurial risk. Courts must analyze whether the profits interest seems like one in which an investor may receive a return that approximates the return that an investor should get. Because there

are many ways to structure profits interests, courts need to be more stringent and cannot conclude that there is such thing as a typical profits interest. And lawyers setting up future Lender type structures need to demonstrate why any given profits interest works and why there is significant entrepreneurial risk that the profits interest may not come to fruition.

2. Trade or Business Test

A second critique of Lender is that the case used an unconventional way to look at the trade or business question. This doctrinal analysis of Lender is important because the case is a memorandum opinion and therefore has no precedential value. Another Tax Court Judge may consider Lender persuasive, but there is no guarantee that another judge will adopt the rationale of the case.

As Part II explained, the traditional way to look at whether someone buying and selling securities is engaged in a trade or business is through the trader-investor-dealer lens. Using a strict doctrinal test is probably bad for a family office taxpayer. These taxpayers do not trade enough to be considered a “trader” nor do they vend securities to other customers like a brokerage house and therefore likely are not considered a “dealer.” The default under this standard would be that a family office would be an investor unable to take a section 162 deduction for investment expenses. Under this traditional analysis, it is hard to see how any family office or private equity fund would ever be engaged in a trade or business. Such analysis follows from the cases described in Part II but may produce an unduly harsh result for family offices or funds that seem to have a legitimate trade or business.

Many courts have not followed this traditional approach, and the result in Lender is unsurprising given the progression of the trade or business doctrine. As one commentator has noted: “Pity the poor Treasury Department and the long-suffering IRS. They won a big victory in the United States Supreme Court in the Higgins case back in 1941 and have spent the better part of the last 70 years defending their victory from Congress and the courts.”156 Investors have been successfully chipping away at the trade or business distinction and the core holding in Higgins ever since. But Higgins is still good law and the courts that chip away too much are likely contravening this precedent.

That said, Part II showed how the trade or business test can apply to private equity and other investment funds in a way that might be consistent with Higgins and other Supreme Court cases. The Tax Court

in *Dagres* and the First Circuit in *Sun Capital* used innovative approaches to argue that a private equity fund is engaged in a trade or business. Given that the Supreme Court decided *Groetzinger*, its last trade or business case, long before the meteoric rise in private equity, such a malleable approach is necessary. Many private equity and investment funds have an important effect on the economy and should be a trade or business for deducting investment expenses. While a fund-of-funds may not have enough activity to constitute a trade or business, it is very likely that private equity funds like the ones in *Dagres* and *Sun Capital* have enough activity to be considered a trade or business.

But even if private equity funds are engaged in a trade or business, should family offices also have a trade or business label? It is likely that many family offices—including the $25 billion family office run by George Soros and the multi-billion office run by the Pritzker Group—are engaged in a trade or business. These funds manage billions of dollars and compete directly with the top private equity and hedge funds for talent and acquisitions. Drawing the line between what is a trade or businesses is difficult, especially considering infamous words that the trade or business inquiry does not depend on “how large the estate or how continuous or extended the work required may be.”

Smaller family offices like Lender Management fall somewhere in between a funds-of-funds and a private equity fund. On one hand, a family office typically does more than a fund-of-funds because they give personalized advice to the group of individuals that invest in the funds. On the other hand, a family office typically takes a minority ownership in companies and does not have the same business model as a typical private equity fund.

The Tax Court noted that Lender Management provided “services similar to those of a hedge fund manager,” and “did substantially more than keeping records and collecting interest and dividends.” Yet the family office only selected the fund that would deploy the family’s capital. Nor did the family office conduct due diligence about the funds in which it invested; instead, it outsourced that function to outside accountants. Unlike the general partner in *Dagres*, the Lender family office did not “investigate” companies, “negotiate investment terms, help the companies to thrive, design exit strategies, [or] liquidate the

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158 *See How the 0.001% invest*, THE ECONOMIST, Dec. 15, 2018.
161 *Id.* at *12.
162 *Id.* at *6.
holdings.” Nor was the family office like the private equity fund in *Sun Capital* that adopted an active and substantial role in the “management and supervision” of the portfolio companies that it acquired. Put differently, it is unclear given the court’s reasoning why Lender Management was in a trade or business.

This paper advocates for courts to take the approach of Judge Lauber in *Hellmann*, which is discussed in the next section, by asking narrow questions that get to the essence of the family office’s activities. This test aligns with the “investment plus” standard in *Sun Capital* because it seeks to ask whether the family office has done enough to satisfy some sort of “plus” standard that sets it apart from an investor like the taxpayer in *Higgins*. Asking questions about how the family office operates is more helpful than asking how that family office relates to a traditional investment fund because, as Part II showed, there is so much variety in the private equity and hedge fund world.

**B. The Narrow Lender Holding**

The take-away from the *Lender* case is that a family office can be a trade or business, not that every family office is a trade or business. And even with the beneficial income tax deduction, some family offices may choose not to create a *Lender* structure because creating that type of structure would lead to other adverse tax consequences. This paper lists four reasons why the costs to implementing this structure may exceed the benefits.

1. **Many Family Offices Do Not Satisfy the Lender Standard**

First, many family office structures cannot strictly fall into the *Lender* guidelines and may be unable to claim the section 162 deduction. An order by Tax Court Judge Lauber in *Hellmann v. Commissioner* illustrates this point. Both parties in the case moved for summary judgment on the issue of whether the family office was engaged in a trade or business. The family office was a limited liability company owned equally by four individuals of the same family. The family created six investment partnerships where the family office

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166 Id. at 1.
167 Id.
owned 1% of the partnership and trusts created for the benefit of the four individuals owned the rest of the 99%. 168

Judge Lauber noted that although the cases consolidated before him “appear to resemble Lender Management in some respects,” there were key distinctions: all four individuals were from the same family and were on good terms. 169 Judge Lauber declined to state that the family office was engaged in a trade or business by virtue of the profits interest that the family office received. 170 Unlike the family office in Lender that was controlled by one family member who had a 99% profit interest, the family office in Hellmann was controlled by all four members who, if they also proportionally owned the investment partnerships, “would simply replace investment income that each person would otherwise have derived from the investment portfolios.” 171 Or, put in Whipple terminology, the return of the family office would simply be that of a typical investor.

In that Order, Judge Lauber said that he planned to consider at least five non-exclusive factors for determining this question:

1. the manner in which the family office was compensated for its services;
2. the nature and extent of the services provided by the family office employees;
3. the relative amounts of expertise possessed and time devoted by family office employees versus outside investment managers and consultants;
4. the individualization of investment strategies for different family members with differing investment preferences and needs; and
5. 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. 172

Although Judge Lauber ordered the parties to brief why the family office was or was not engaged in a trade or business, he eventually denied the both sets of motions and the parties settled outside court. We do not know whether a judge would find that the family office in Hellmann is a trade or business, but this paper speculates that the taxpayer

168 Id.
169 Id. at 3.
170 Id.
171 Id. at 4.
172 Id. at 3-4.
agreed to the settlement because it did not think that its chances were good.

The corollary of Hellmann and Lender is that family offices can satisfy the trade or business test only if the family office advises a multi-generational, contentious, and geographically dispersed family and receives compensation in a way that differs from a normal investor’s return. Perhaps some family offices that do not follow this structure may still qualify as a trade or business, but given the extremely factual nature of this inquiry, there is no guarantee as to how a court will view a new fact pattern. And given this paper has argued that the Lender rationale is not persuasive, it is unclear how a future court will interpret this type of fact pattern.

The broader point is that this Hellmann order should give lawyers and family office advisers pause. Although clients may have a strong urge to conclude that their family office is a trade or business based on the Lender decision, advisers must temper their client’s expectations. This is an unsettled area of the law that the IRS will be eager to litigate.

2. Some Family Offices Will Need to Register with the SEC

Second, many family office structures will be unable to implement a Lender structure without registering with the Securities and Exchange Commission (SEC). An important consideration to this structure, not mentioned in the Tax Court’s opinion, is that the family office did not need to register as an investment advisor with the SEC. Generally, people or entities that give investment advice are labeled as an “investment adviser,” which means that they need to register with the SEC and comply with the Investment Advisers Act of 1940.173

SEC rule 202(a)(11)(G)-1 provides an exception to registration for certain family offices, which it defines as an entity that “has no other clients other than family clients . . . is wholly owned by family clients and is exclusively controlled . . . by one or more family members . . . [and] does not hold itself out to the public as an investment adviser.”174 Family clients generally include any family member (including entities controlled by trusts for the benefit of that family member) or a current or former “key employee,” which is defined as someone who “in connection with his or her regular functions or duties, participates in the investment activities of the family office or affiliated family office . . . .”175

If the family office meets this definition, the office need not register as an adviser with the SEC.176 The exemption from the Advisers Act is

175 Id. § 275.202(a)(11)(G)-1(d)(8).
176 Id. § 275.202(a)(11)(G)-1(a).
essential: without it, it is likely that the costs of complying with the adviser rules would be too burdensome for a small entity like Lender Management.177 The SEC adopted this rule in part because family offices do not act like traditional investment advisers.178 It explained that

[t]he core policy judgment . . . is the lack of need for application of the Advisers Act to the typical single family office. The Act was not designed to regulate the interactions of family members in the management of their own wealth. Accordingly, most of the conditions of the proposed rule . . . operate to restrict the structure and operation of a family office relying on the rule to activities unlikely to involve commercial advisory activities, while permitting traditional family office activities involving charities, tax planning, and pooled investing.179

This rationale creates a win-win situation for family offices like Lender Management who can escape registration from the SEC by managing family wealth and deduct investment expenses by performing actions like an investment adviser. This disconnect may not last forever but is extremely beneficial to family offices that can satisfy this exemption.180

But the rule is not beneficial to all family offices pursuing a Lender structure. As discussed above, the corollary of Lender and Hellmann is that family offices should manage the wealth of multi-generational, disjointed families. Families with multi-generational wealth like the Lender Family will no doubt be able to advise this type of client without having to register with the SEC. But families compromised of one or two generations of wealth (e.g., a husband, wife, and children) will likely be unable to satisfy the income tax standard because the office would look like the taxpayer in Higgins. These types of families would be unable to start a family office that is in a trade or business without advising investments of non-family members, which would require the family office to register with the SEC. For that reason, families with newer wealth will be less likely to create a Lender structure because in order to create such a structure, those families would need to manage outside-the-family wealth and may need to register with the SEC.

177 Kirkland & Ellis, supra note 6 (discussing the costs of complying with the relevant SEC rules).
178 The SEC rule was an outgrowth of a Senate Banking Committee explanation of Dodd-Frank, which said that “[t]he Advisers Act is not designed to regulate the interactions of family members, and registration would unnecessarily intrude on the privacy of the family involved.” Nathan Crow & Gregory S. Crespi, The Family Office Exclusion Under the Investment Advisers Act of 1940, 69 SMU L. Rev. 97, 133 (2016) (quoting the Senate Committee on Banking, Housing, and Urban Affairs).
3. **Profits Interest May Create Unsavory Results**

Third, the profits interest may create a few adverse tax consequences that may negate any income tax benefit of the deduction.

a. **“Deemed Gift” Under Section 2701**

A profits interest may trigger a “deemed gift” under section 2701. This deemed gift applies when the taxpayer retains a preferred equity interest and transfers a subordinate equity interest to another family member. In such a scenario, section 2701 could potentially turn a bona fide profits interest into a deemed taxable gift under a complex valuation formula by valuing the transferor’s retained interest at zero.\(^{181}\)

A family office may trigger this gift tax obligation when it receives a profits interest and the owners of the family office differ from the owners that invest in the family limited partnership. More precisely, the profits interests must be a “subordinate interest,” which would occur if other family members that invest in the family limited partnerships hold onto an “applicable retained interest” that has an “extraordinary payment right” (i.e., a right that “confers a distribution right which consists of the right to a qualified payment and there are 1 or more liquidation, put, call, or conversion rights with respect to such interest”).\(^{182}\) Because partners who receive a profits interest do not receive a liquidation right with the profits interest, section 2701 may apply.

A recent piece of sub-regulatory guidance suggests that the IRS would try to argue that section 2701 applies when a family office receives a simple profits interest. In Chief Counsel Advisory 201442053, the IRS responded to a scenario in which a donor recapitalized an LLC with her two children where the children managed the LLC and received an interest for “all profit and loss” of the LLC.\(^{183}\) The IRS said that this type of recapitalization was subject to section 2701 because “Donor’s interest, which carried a right to distributions based upon an existing capital account balance, is senior to the transferred interests, which carried only a right to distributions based on future profit and

\(^{181}\) In short, if the section 2701 rule applies to the profits interest transfer, the value of the gift is equal to (A) the total value of interest of the transferor and the transferee post-transfer minus (B) the aggregate amount of property retained by the transferor (where some of the transferor’s retained interests are deemed to be zero). N. Todd Angkatavanich, et al., *Carrying the Day with Carried Interest Wealth Transfer Planning for Fund Principals*, NYS Soc’y CPAs (Dec. 1, 2019), http://www.nyscpa.org/news/publications/the-tax-stringer/stringer-article-for-authors/carrying-the-day-with-carried-interest-wealth-transfer-planning-for-fund-principals. This approach contrasts with the general gift valuation rules that value an interest by trying to approximate what someone would pay for that gift. *Id.*


\(^{183}\) I.R.S. CCA 201442053.
gain.”\textsuperscript{184} Although not directly on point, it seems like the IRS would similarly argue that profits interest like the one in the \textit{Lender} case would also be subject to section 2701 because the family office would receive a profits interest that did not include an immediate distribution right. But there is much lacking in the IRS’s rationale.

Prominent practitioner Richard Dees argues that the IRS’s memorandum was wrongly decided and did not provide enough explanation to show how that type of profits interest would be taxable under section 2701.\textsuperscript{185} Of relevance to this paper, he argued that the capital interest was not necessarily an applicable retained interest because it did not necessarily have an extraordinary payment right if the partnership agreement did not provide for a priority distribution of capital:

As in many private equity partnerships, the amended LLC agreement might provide that all capital would be distributed before any profits are distributed. If so, the memorandum is correct that the distributions of profits would be subordinate to distributions of capital, although a capital distribution still would not be a distribution right. . . . The memorandum states that distributions of capital were permitted, but capital distributions may have been permitted only after all profits were distributed. If that was the case, the profits interest would be senior to the capital interest. Alternatively, capital distributions may have been prohibited until the end of the term, at which time all capital would be distributed pro rata to the members. The right to participate proportionately in that kind of liquidating distribution would not be a senior interest or a distribution right.\textsuperscript{186}

Put differently, Dees argues that a capital interest is not necessarily an extraordinary payment right, and if it is not one, section 2701 will not apply. Instead, Dees argues that a simple profits interest (perhaps like the one in \textit{Lender} or the CCA from 2014) should not be subject to 2701.\textsuperscript{187} Under this logic, family offices may be able to plan around section 2701 by providing that the profits interest has priority over the capital interest. This distribution right may be unsuitable because it changes

\textsuperscript{184} Id.

\textsuperscript{185} Richard L. Dees, \textit{Is Chief Counsel Resurrecting the Chapter 14 ‘Monster’?}, 145 \textit{TAX NOTES} 1279 (Dec. 15, 2014).

\textsuperscript{186} Id.

\textsuperscript{187} Richard L. Dees, \textit{Profits Interests Gifts Under Section 2701: ‘I Am Not a Monster’}, 123 \textit{TAX NOTES} 707 (May 11, 2009) (arguing that a “simple partnership profits interest” should not be subject to gift tax under section 2701 because a “corporate equivalent” of that structure would not be taxed under the statute).
the economic deal that family members agree to, but it would be preferable from a transfer tax perspective.\textsuperscript{188}

This paper does not solve the puzzle of when section 2701 applies in the family office context. How the deemed gift rule applies in this situation is inherently a factually intensive question that applies differently to one family office than it does to other family offices. The bigger point remains: some family offices may be unable to create a profits interest structure because section 2701 may trigger a gift tax obligation.

b. \textit{Immediate Taxation if Outside Rev. Proc. 93-27}

Profits interest may also create an unexpected taxable event for family offices. Generally, service providers need to recognize taxable income equal to the fair market value of any property that they receive “in connection with the performance of services.”\textsuperscript{189} Courts have long struggled with whether a profits interest is immediately taxable upon the grant of the interest.\textsuperscript{190} Fearing a circuit split, the IRS released a favorable Revenue Procedure in 1993 that created a safe harbor for partnerships granting profits interests.\textsuperscript{191}

The Revenue Procedure said that “if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity,” the granting of a profits interest will not be a taxable event except in the following situations:

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\textsuperscript{188} Of course, there are two easy fixes to section 2701 in the non-family office context that likely do not work here. First, the partnership agreement may lock in the interests of its members and prohibit capital withdrawals. In this case, the other family members who did not receive a profits interest would not have an “applicable retained interest” because they would not have a right to a distribution or liquidation. But prohibiting capital withdrawals would weaken the trade or business argument because the \textit{Lender} court noted that it was a positive fact that the investors could not pull their money from the family limited partnerships at any time. See \textit{supra} note 147 and accompanying text. Second, the partnership agreement could grant a “vertical slice” of equity in the family limited partnership that “is proportionally the same as the transferred interest.” See \textit{Angkatavanich et al.}, \textit{supra} note 181. But this would mean that the partnership would also grant a capital interest, which would weaken the trade or business argument and result in immediate taxation to the family office (at ordinary rates).

\textsuperscript{189} I.R.C. § 83.

\textsuperscript{190} For example, The Seventh Circuit said that a profits interest “with determinable market value” was taxable income, but the Eighth Circuit suggested in dicta that a profits interest was not taxable income. \textit{Compare} Diamond v. Comm’r, 56 T.C. 530 (1971), \textit{aff’d}, 492 F.2d 286 (7th Cir. 1974) \textit{with} Campbell v. Comm’r, 943 F.2d 815, 823 (8th Cir. 1991).

\textsuperscript{191} The IRS helpfully defined a profits interest as any interest that is not a capital interest. Rev. Proc. 93-27, 1993-2 C.B. 343. It also said “[a] capital interest is an interest that would give the holder a share of the proceeds if the partnership’s assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership.” \textit{Id.}
(1) If the profits interest relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease;

(2) If within two years of receipt, the partner disposes of the profits interest; or

(3) If the profits interest is a limited partnership interest in a “publicly traded partnership” within the meaning of section 7704(b) of the Internal Revenue Code.192

This Revenue Procedure provides clarity and a taxpayer-favorable result to those looking to grant and receive profits interests. But family offices may be unable to take advantage of this taxpayer-favorable Revenue Procedure in certain situations.

For example, a person providing services to the family limited partnership through a corporation does not fall within the safe harbor and may be taxed on the grant of the profits interest. Put more directly, the corporation that receives the profits interest would satisfy the section 83(b) safe harbor, but the person who works for the corporation and performs services to the partnership would be subject to section 83(a) because he or she performed services to the family limited partnership, the property “is transferred to any person other than the person for whom such services are performed,” and the safe harbor does not apply. Thus, the owner of the corporation cannot rely on the 1993 Revenue Procedure and may be subject to phantom taxable income under section 83.

Additionally, the family office may be unable to take advantage of the safe harbor if the profits interest creates a “certain and predictable stream of income.” For example, the Lender profits interest was based on changes in “net asset value,” which would seem to be a certain and predicate stream of income provided that the family office invests in assets like equities and bonds that are almost certain to increase in value. Although it is ultimately a factual finding as to whether the payment from the profits interest is “certain” or “predictable,” this paper notes that this test may be comparable to the test for disguised fee for services under section 707(a)(2)(A) and whether the profits interest lacks significant economic risk. Both tests get at the same issue: did the partner receive something that is risky and may not come to fruition or did the partner receive an asset that is virtually certain to bring about some payments? Only the profits interests that are risky enough can fall within this safe harbor and avoid immediate taxation.

192 Id.
c. Capital Gains into Ordinary Income

In addition to creating an income event upon grant, the profits interest that a family office receives may turn capital gain income into ordinary income. Without a Lender structure, a family would invest through a series of family limited partnerships. If the partnerships invested in equities or private equity funds, the partnerships would likely be able to pay tax on any gain at preferential capital gain rates. A family office that receives a profits interest may also be eligible to pay tax on gain at preferential capital gains rates. But a family office that structures its profits interest incorrectly may need to pay tax on this profits interest at ordinary rates in three situations.

First, as discussed above, if the profits interest lacks significant entrepreneurial risk, the IRS will recharacterize the profits interest as a disguised fee for management services under section 707(a)(2)(A). In this situation, part of the profits interest would be ordinary income to the family office. As Part II explored, lawyers will likely try to create a profits interest that would create enough significant entrepreneurial risk to satisfy the disguised fee for services regulations, but not so much that the profits interest is unlikely to come to fruition. Drafting this type of profits interest is difficult, especially if the family office cannot estimate how much money it will make.

Second, a taxpayer that receives a profits interest outside of the safe harbor discussed above (e.g., if the profits interest creates a “certain and predictable stream of income”) will need to pay tax equal to the fair market value of the profits interest at the time of issuance. Although the profits interest would be a capital asset, the family office would have to pay ordinary rates because they would not qualify for the long-term preferential capital gains rate.

Third, section 1061 may turn certain types of gain into short-term capital gains. This section applies to an “applicable partnership interest” that is “transferred to . . . the taxpayer in connection with the performance of substantial services by the taxpayer . . . in any applicable trade or business.” Section 1061’s definition of “trade or business” applies to an entity that invests, develops, or raises capital “on a regular, continuous, and substantial basis,” which is potentially broader than the section 162 definition. If a family office sells a profits interest that is characterized as an applicable partnership interest and is sold within three years of grant, the family office gain will be recharacterized from long-term capital gain property into short-term capital gain property. Advisers need to be cautious to implement a profits interest structure.

\[193\] I.R.C. § 1061(c)(1).
\[194\] Id. § 1061(c)(2).
without addressing these risks. Family offices should weigh the risk of triggering a gift tax obligation, immediate taxation on grant, and ordinary taxation of profits interest against the benefit of having a profits interest in the trade or business analysis.

4. Family Limited Partnerships Will Still Be Unable to Deduct Investment Expenses

Fourth, families may be unable to deduct outside investment management expenses if those expenses accrue in family limited partnerships and not through the family office. In the Lender case, the Tax Court said that the family office was engaged in a trade or business but did not say that the family limited partnerships (M&M, Lenco, or Lotis) were engaged in a trade or business. The IRS addressed a similar point in Revenue Ruling 2008-39, which considered a situation where an investor invested in an upper-tier partnership (not in a trade or business) that in turn invested in a lower-tier partnership (that was in a trade or business). The IRS said that the management fee that the lower-tier partnership charged the upper-tier partnership would be a section 212 expense because the “entity” theory would apply to whether an entity is in a trade or business.

For example, M&M would be unable to deduct any management fee that it was charged even though Lender Management was able to deduct its business expenses. M&M economically incurred two types of management fees: one related management fee and one management fee from outside private equity funds. Both types of fees would be section 212 expenses and thus not deductible. Nevertheless, most of the compensation that Lender Management and outside private equity funds charged M&M was in the form of a profits interest. This compensation is preferable to M&M because the entity would receive less gross income rather than a larger amount of gross income less a nondeductible section 212 expense. Still, the about 2% management fee is not insignificant in many cases.

Families are likely unable to deduct management fees of outside private equity and hedge funds even after Lender. In most cases, these outside investment fees would still be non-deductible section 212 expenses, so creating a Lender structure would not help a family office unless the office itself has a significant amount of operating expenses.

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196 Id. See also Goodwin v. Comm’r, 75 T.C. 424 (1980), aff’d, 691 F.2d 490 (3d Cir. 1982).
V. Conclusion

This article has considered the Lender decision and its impact on family offices trying to deduct investment expenses. Because the Tax Court did not adequately address the profits interest of the family office and did not frame the trade or business analysis in the most persuasive way, this paper has suggested that a future court may not accept the rationale of the Lender court. Additionally, this paper highlights several ways in which a family office that implements a Lender structure may not benefit as much as they would hope. Implementing a family office structure may create adverse income tax and gift tax consequences that may negate any income tax benefit from deducting investment expenses of the family office.
What If Granny Wants to Gamble?
Balancing Autonomy and Vulnerability in the Golden Years

Mary F. Radford*

I. INTRODUCTION

When I am an old woman I shall wear purple
With a red hat which doesn’t go, and doesn’t suit me.
And I shall spend my pension on brandy and summer gloves
And satin sandals, and say we’ve no money for butter.¹

In the late 1990s, the words of this poem inspired a global social organization known as the “Red Hat Society.” Women in the Red Hat Society “victoriously celebrate turning 50 and entering into the next phase of their lives.”² Their signature outfit consists of a purple ensemble and a red hat (that doesn’t match). The women in this Society “embrac[e] a renewed outlook on life filled with fun and friendship, fulfilling lifelong dreams.”³

The poet, Jenny Joseph, in dressing her “old woman” in the rich but mismatched palette of red and purple, highlights accurately the conflicting perceptions that our society holds today about older women in America.

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³ Id. We all know, of course, that grown men would never join a society in which they parade around in funny red hats — with the exception of the red fez worn by Shriners at their parades and functions. See The Fez, SHRINERS INT’L. (June 9, 2014), https://www.shrinersinternational.org/ SHRINERS/ History/Fez.
A. Women in Purple

First, Ms. Joseph’s “old woman” chooses to wear purple. The color purple has historically been associated with royalty, wealth, and power. In ancient Rome, only the emperors and other members of the elite classes were allowed to wear togas that had purple borders.4 Julius Caesar was said to be the first ruler of Rome to be allowed to wear a toga that was entirely purple.5

But the royal color of purple was not consigned exclusively to men. History is replete with many women — older women — who have donned this royal color and whose lives have been imbued with all of the power that the color signifies.

Queen Elizabeth I of England wore a mantle of purple velvet when she was crowned Queen in 1559.6 She ruled England for almost 45 years until her death at age 69 and an entire era bears her name.7 Elizabeth I followed the lead of her father, King Henry VIII, by enacting a series of “sumptuary laws”8 that stated, among other things, that only “the King,

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5 *Id.* Part of the reason that the color purple was reserved for the wealthy is that it was so expensive to produce purple dye. Purple dye in ancient times was extracted from a small mollusk-type shellfish that lived in the Mediterranean Sea and it took about 10,000 of these small creatures to produce just one gram of the dye (which in turn was only enough to color the hem of a garment).
Queen, King’s mother, children, brethren, and sisters, uncles, aunts” were allowed to wear “[a]ny silk of the color purple.”

The royal color purple was also worn by Victoria I, Queen of the United Kingdom of England and Ireland and Empress of India. Queen Victoria reigned for 63 years and 216 days until her death at age 81. She also lent her name to an era.

And, of course, Queen Elizabeth II, the longest-reigning English monarch, who at age 94 is celebrating the 69th year of her reign, also enjoys wearing the color purple.

So, aging for women (as well as men) can bring the power born of experience, maturity, creativity, and wisdom. In our own lifetimes we have witnessed older women who have figuratively donned the purple robe of power:

1) Golda Meir came out of retirement in 1969 to be elected as the first woman Prime Minister of Israel. She was age 71 at the time.

2) Ellen Johnson Sirleaf became President of Liberia at age 68. She is the first elected female head of state in Africa as well as a winner of the Nobel Peace Prize.

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10 In 1862, the purple dress that Queen Victoria wore to the Royal Exhibition was colored with one of the world’s first synthetically-created dyes. Anni Turnbull, *Mauve, an unexpected discovery*, MUSEUM OF APPLIED ARTS & SCI. (Oct. 2, 2013), https://maas.museum/inside-the-collection/2013/10/02/mauve-an-unexpected-discovery/.


12 “Queen Victoria (1819-1901) was the first English monarch to see her name given to the period of her reign whilst still living.” Anne Shepherd, *Overview of the Victorian Era*, HIST. IN FOCUS (Apr. 2001), https://www.history.ac.uk/ihr/Focus/Victorians/article.html.

13 Elizabeth II was born on April 21, 1926. She became queen when her father died in February 1952 and she was crowned on June 2, 1953. *Queen Elizabeth II Biography*, BIOGRAPHY.COM (Jan. 13, 2020), https://www.biography.com/royalty/queen-elizabeth-ii. For pictures of Queen Elizabeth II wearing the color purple, see The Queen’s best fashion moments in pink and purple, HELLO!, Apr. 21, 2019, https://ca.hellomagazine.com/fashion/02018042044521/queen-elizabeth-best-fashion-moments-pink-purple/1/.


3) Angela Merkel, now age 66, was the first female Chancellor of Germany\textsuperscript{16} and Time Magazine’s “Person of the Year” for 2015.\textsuperscript{17}

And, of course, four very strong and powerful American women have all donned the robe of power, albeit a black one rather than a purple one: Justices Sonya Sotomayor,\textsuperscript{18} Elena Kagan,\textsuperscript{19} Ruth Bader Ginsburg,\textsuperscript{20} and Sandra Day O’Connor.\textsuperscript{21} All four of these women were age 50 or older when they were appointed to the Supreme Court of the United States.

B. Women in Red

There is another side to the story of aging, however. Unfortunately, the canvas for many older women in America is not painted purple — that is, they do not lead lives of power and wisdom.

You will recall that the poet Jenny Joseph also dresses her old woman in a red hat that doesn’t match. Red is a color with many symbolic meanings but included among them are danger, passion, rage, and madness.\textsuperscript{22} And in fact, Jenny Joseph’s old woman intends to do things that could perhaps be characterized as “crazy” or “mad.” Recall that she is planning to spend her pension on brandy and pretty clothes rather than on butter.

She has additional plans. Imagine if you came across this woman on the street:

\begin{quote}
I shall sit down on the pavement when I am tired,  
And gobble up samples in shops and press alarm bells,  
And run my stick along the public railings,  
And make up for the sobriety of my youth.\textsuperscript{23}
\end{quote}

\begin{flushright}
\textsuperscript{16} Nicki Peter Petrikowski, \textit{Angela Merkel: Chancellor of Germany},ENCYCLOPEDIA BRITANNICA (Nov. 27, 2019), https://www.britannica.com/biography/Angela-Merkel.  
\textsuperscript{19} Justice Kagan was born on April 28, 1960 and confirmed as Associate Justice and sworn in on August 7, 2010. Id.  
\textsuperscript{20} Justice Ginsburg was born on March 15, 1933 and confirmed as Associate Justice in August 1993. Id.  
\textsuperscript{21} Justice O’Connor was born on March 26, 1930 and confirmed as Associate Justice on September 21, 1981. She retired from the Supreme Court on January 31, 2006. Id.  
\textsuperscript{23} Joseph, supra note 1.
\end{flushright}
When older people — particularly older women — engage in these types of behaviors, those around them begin to worry. And rightfully they should, because for far too many older women, their lives and freedom are overshadowed by vulnerability, isolation, and our 20th century version of “madness” known popularly as “neurocognitive disorder” or “dementia.”

C. Elder Financial Abuse as a Women’s Issue

You may wonder why I am highlighting the issues about which I am speaking today as “women’s issues.” Statistics show us that there is a rather large gender gap in the population and lifestyles of older Americans. In the general U.S. population the genders are almost equally divided with 97 males per every 100 females. But as we age, the number of women begins to outstrip the number of men so that by age 85, women outnumber men almost 2 to 1.

Additionally, many more women than men are “alone” in their old age in that they are widowed, unmarried, divorced, or single. U.S. Census Bureau statistics show us that, for those people age 65 and over who are not institutionalized (that is, those who do not live in a setting such as a nursing home), only 20% of the men live alone, while 35% of the women live alone. And the gap increases with age such that 46% of women age 75 and older live alone, compared to only 27% of men.

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24 The fifth version of the Diagnostic and Statistical Manual of Mental Disorders (DSM-5), published by the American Psychiatric Association in 2013, replaced the term “dementia” with “neurocognitive disorder.” The theory was that the term “dementia” was stigmatizing for older adults. Neurocognitive disorders are classified as “minor” or “major.” “Major and mild neurocognitive disorders exist on a spectrum of cognitive and functional impairment. Major neurocognitive disorders corresponds to the condition referred to in DSM-IV as dementia.” George T. Grossberg, The DSM-5 and Neurocognitive Disorders: Diagnosis and Treatment Options, PSYCHIATRY & BEHAVIORAL HEALTH LEARNING NETWORK (July 8, 2015), https://www.psychcongress.com/article/dsm-5-and-neurocognitive-disorder-diagnosis-and-treatment-options.


Sometimes, to fill the void, people who live alone engage in unusual behaviors.

Our poet, Jenny Joseph, speaks (with glee) of the things that older women can do:

You can wear terrible shirts and grow more fat,
And eat three pounds of sausages at a go,
Or only bread and pickle for a week,
And hoard pens and pencils and beer mats and things in boxes.28

So what happens today when an older woman wants, for example, to “hoard pens and pencils and beer mats and [other] things in boxes”? Will she have the freedom to do these things . . . or will she be considered “mad”?

1. Huguette Clark

Let’s look, for example, at the life of this woman in purple, whose name is Huguette Clark.29 Huguette Clark could arguably have been labelled a “hoarder,” although I doubt that word had the same notoriety in the 1960s (when Huguette Clark was in middle age or when Jenny Joseph wrote her poem) as it does now.30

When Huguette Clark died in 2011 at age 104, she owned a collection of dolls: over 1100 dolls, worth about $1.7 million.31 These dolls

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28 Joseph, supra note 1.
29 Self Portrait, EMPTY MANSIONS, http://www.emptymansionsbook.com/self-portraits (last visited May 5, 2020). The information in this lecture pertaining to Huguette Clark is derived primarily from Bill Dedman and Paul Clark Newell, Jr.’s book, Empty Mansions: The Mysterious Life of Huguette Clark and the Spending of a Great American Fortune. The slide shown at this point in the lecture was a self-portrait of Ms. Clark wearing a purple dress that was taken with Ms. Clark’s own Polaroid camera.
30 See Cristie Glasheen et al., Impact of the DSM-IV to DSM-5 Changes on the National Survey on Drug Use and Health, SUBSTANCE ABUSE & MENTAL HEALTH SERVS. ADMIN. 1, 137 (June 2016). The 2013 update of the Diagnostic and Statistical Manual of Mental Disorders (DSM-5) now actually lists “hoarding disorder” as a psychiatric condition characterized by “[p]ersistent difficulty discarding or parting with possessions, regardless of their actual value.” Id.; David Mataix-Cols et al., Hoarding Disorder: A New Diagnosis for DSM-V?, DEPRESSION & ANXIETY 1, 7 (2010) (stating that the DSM-IV did not list this behavior as a separate disorder but rather as one of the eight criteria for Obsessive-Compulsive Personality Disorder).
were well-cared-for as Mrs. Clark commissioned outfits for them from designers like Christian Dior and she had numerous dollhouses designed for them by famous architects. Mrs. Clark owned three high-end Fifth Avenue apartments in New York City. She also owned mansions in California and Connecticut. She could afford such opulent surroundings because she had inherited millions of dollars from her father, who was a copper baron. But Mrs. Clark was not living in any of these luxurious homes when she died. Many years prior to her death, she was admitted to New York’s Doctor’s Hospital. At that time she was painfully thin and had numerous cancerous lesions on her face. She underwent surgeries and was then urged by her doctors to go home, but she chose to remain in her hospital room. She only left that room when Doctor’s Hospital merged with Beth Israel Hospital and the building eventually closed down. She

32 Dedman & Newell, supra note 31, at 140. Huguette Clark was briefly married but secured a divorce two years into her marriage after a one-year separation from her husband. “After her divorce, Huguette reclaimed her maiden name, but she kept the ‘Mrs.,” indicating perhaps that she was no longer in the market for a husband.” Id. at 159. 33 One portion of Empty Mansions describes how the then-reclusive 50-year-old Huguette Clark attended a House of Christian Dior showing in order to see dresses for her dolls. Id. at 177. She ordered expensive clothes made of expensive fabrics from Paris. Id. at 180. 34 Id. at 177-80, 182-83. 35 After her death, these apartments sold for a total of $54.8 million. Id. at 348. 36 This home in Santa Barbara, California, called Bellosguardo, was built by Huguette’s mother in 1933-37. Id. at 193-94. 37 Her Connecticut mansion, called Le Beau Chateau, sold after her death for $14 million. Id. at 349. 38 Huguette Clark was the daughter of multimillionaire W.A. Clark. Id. at 3. 39 As described in Empty Mansions, Huguette Clark chose Doctor’s Hospital “which wasn’t Manhattan’s finest but was close to a friend’s apartment.” Id. at xxvi. Reporter Dedman describes Doctor’s Hospital as follows: it “was better known as a fashionable treatment centre for the well-to-do, a society hospital, a great place for a facelift or for drying out. Michael Jackson had been a patient, as had Marilyn Monroe, James Thurber, Clare Boothe Luce and Eugene O’Neill.” Bill Dedman & Paul Clark Newell, Jr., The Extraordinary story of Huguette Clark and the $30m she left to her nurse, The Guardian (Jun. 27, 2014, 2:08 PM), https://www.theguardian.com/lifeandstyle/2014/jun/27/huguette-clark-and-the-fortune-she-left-to-her-nurse. 40 Dedman & Newell, supra note 31, at xxv. 41 Id. at 230. 42 Her physician, internist Dr. Henry Singman, assured her that she could have round-the-clock nurses at home and that he would visit daily. “I had strongly urged that she go home,” he said. She was, however, “perfectly happy, content, to remain in the situation she was in.” When one of the first night nurses kept urging her to move back home, Huguette fired her. In the end Dr. Singman accepted her decision, writing in her chart in 1996: “I fervently believe that this woman would not have survived if she had been discharged from the hospital.” Dedman & Newell, supra note 39.
then transferred to a room in the main Beth Israel Hospital. All in all, she spent the last 20 years of her life living not in the luxury she could afford but in spartan hospital surroundings.

Like so many older women today, Huguette Clark was basically alone. She had no spouse or children, only distant relatives. She was reclusive and refused to allow visits from those family members. She expressed the fear that everyone was out to get her money. It is said that her dolls were her closest companions. While Mrs. Clark was in the hospital she hired an assistant to take care of the dolls and bring back photographs of them. Occasionally a few special dolls would be brought to the hospital for short visits. But despite these eccentricities, throughout the final years of her life, Mrs. Clark continued to manage her properties from afar, showing a meticulous and ordered mind and a sound grasp of her many assets.

Mrs. Clark also was a very generous woman. She gave numerous gifts to the nurses and others who cared for her while she was in the hospital and to the family of her best friend. She also made sizeable contributions to the hospitals themselves.

One nurse, Hadassah Peri, was a particular object of Mrs. Clark’s affection and generosity. During the course of their relationship, Mrs. Clark gave Hadassah Peri and the Peri family numerous gifts, including

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43 Dedman & Newell, supra note 31, at 287.
44 Id. at xxvi, 232. Huguette Clark never told her relatives or acquaintances that she was in the hospital. Id. at 239.
45 Her father, sister, and mother had all predeceased her. Her mother (the last of her close family members to die) died in 1963. Id. at 170. Her closest blood relatives were the great-grandchildren and great-great grandchildren of her father, who were descendants of his children from his first marriage. Id. at 325. Most of them had never met Mrs. Clark. Id. at 326. Huguette Clark did have one close friend, Suzanne Pierre, who also acted as a personal secretary for her. Suzanne Pierre eventually developed Alzheimer’s disease. Bill Dedman, At 104, the mysterious heiress Huguette Clark is alone now, NBC News (May 23, 2012, 6:06 AM), https://via.hypothes.is/http://www.nbcnews.com/id/38719231/ns/business-local_business/t/mysterious-heiress-huguette-clark-alone-now/#fullstory.
46 Dedman & Newell, supra note 31, at 228.
47 Huguette Clark’s close friend, Suzanne Pierre, once stated, “Her dolls are her closest companions.” Id. at 227.
48 The services of her personal assistant, Chris Sattler, are described in Empty Mansions. Id. at 240-45.
49 Id.
50 For example, a chart reproduced in Empty Mansions lists a total of over $600,000 in gifts made in 1991 alone. Id. at 261.
51 During her first decade in the hospital, she gave a total of $940,000 to the hospital, often giving gifts in honor of her doctors. Id. at 281.
52 Hadassah Peri served as the day nurse for Huguette Clark from the first day Ms. Clark entered the hospital. Id. at 229. She worked for Mrs. Clark for the twenty years she was in the hospital. Id.
cash (including a check for $5,000,000), a total of seven residences, and many cars, including a Bentley.53

Huguette Clark died with a will that left an additional $15 million and her doll collection to Hadassah Peri54 and the bulk of her $300 million dollar estate to a foundation of which her attorney and her accountant would be trustees (with a sizeable trustee fee attached).55 Mrs. Clark’s distant relatives challenged the will, alleging that she was mentally vulnerable and had been manipulated by her doctors and caregivers and her attorney and accountant.56 They cited her obsession with dolls and her reclusive lifestyle as illustrative of her vulnerability and her lack of decision-making capacity.57

The challenge to Huguette Clark’s will was settled only moments before jury selection was set to begin58 so we’ll never know whether a jury would have found that Huguette Clark was of sound mind when she signed her will or whether she was unduly influenced by Hadassah Peri and others. Hadassah agreed in the settlement to forego the bequests of the dolls and the millions, but she was allowed to keep the homes and the cars and most of the millions of dollars that Mrs. Clark had already given her in gifts.59 The attorney and the accountant agreed to relinquish their appointments as trustees and disclaim the bequests given them in Mrs. Clark’s will.60 The estate paid millions of dollars in taxes; $34.5 million was split among those distant relatives; and the remainder went to fund her arts foundation.61

Mrs. Clark’s story is an example of how older women may wish to indulge their eccentricities but, in doing so, also may run the risk of losing their freedom to dispose of their property as they wish. This happens because our society, usually for all the right reasons, wishes to protect them from making bad decisions about their own property and welfare.

53 Id. at 260-65.
54 Id. at 335.
55 Id. at 299.
56 See id. at 325.
57 See id. at 339.
59 Hadassah Peri agreed to return $5 million dollars in gifts she had received from Huguette Clark. See DEDMAN & NEWELL, supra note 31, at 349.
60 Id.
61 Id.
2. **Brooke Astor**

I do not want any of us to underestimate the extent or severity of the fact that some older vulnerable women are manipulated by people who take advantage of their mental frailty.

Take, for example, Brooke Astor. She was a socialite and a philanthropist who died at age 105. She was somewhat of an unusual woman, even when she was younger. After the death of her beloved second husband, she chose to marry the very wealthy but notoriously angry alcoholic, Vincent Astor. Mr. Astor, who was in the process of getting a divorce from his first wife when he met Brooke, had already proposed to another woman. To convince that woman to marry him, Mr. Astor told her that his doctors had said that he only had three years to live. Reportedly the woman responded, “But Vincent, what if the doctors are wrong?” Well, that woman didn’t marry Vincent Astor but Brooke did. Vincent lived another 5 1/2 years and died leaving over $100 million to Brooke and the Vincent Astor Foundation.

Unfortunately all of that wealth was not enough to protect Brooke Astor from a predator. This predator came in the form of her own son, Anthony Marshall. After she died, he was convicted (in his 80s) of grand larceny, having looted millions of dollars from her estate.

3. **Sara Cochran**

So even the wealthiest and most powerful women are vulnerable to being preyed upon by thieves and scam artists, whether these predators be relatives or strangers.

But let’s look at someone less wealthy and less powerful, a woman who lived in Cobb County, Georgia. Her name is Ms. Sara Cochran. Ms. Cochran was a woman in her 70s who loved to gamble. And she often won . . . or at least she thought she had won. Between the ages of 75 and 79, Sara Cochran spent somewhere between $100,000 and

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63 She was married to her first husband, Dryden Kuser, for 11 years until their divorce. The marriage produced a son, Anthony. Her second marriage, which lasted 20 years, was to Charles Marshall, the “love of her life” (whose surname Anthony adopted), *Id.* See John Richardson, *The Battle for Mrs. Astor*, VANITY FAIR HIVE (Sept. 4, 2008), https://www.vanityfair.com/news/2008/10/astor200810.

64 See Richardson, *supra* note 63.

65 *Id.*

66 See Berger, *supra* note 62; see also Richardson, *supra* note 63.


$700,000 on foreign lotteries, including the “Sweet Steaks Company of Australia.” You have probably seen examples of this scam. The email notification arrives: “Congratulations, you have won $75 million and all you need to do to collect is to prepay $7000 in taxes. Click here.” Unfortunately, this was not money that Sara Cochran could afford to lose. An emergency conservator appointed for her by the probate court reported to the court that Mr. and Ms. Cochran’s estate would be completely exhausted within a couple of years if they continued their pattern of spending money on lotteries and sweepstakes. At the court hearing on whether to impose a permanent conservatorship, Ms. Cochran herself took the stand and testified and exhibited a fairly sound grasp of her own finances (perhaps much like what Huguette Clark had exhibited). But then Ms. Cochran told the judge that she needed to hurry up and leave the courthouse because a man from Jamaica was waiting for her to call him so he could bring her a check for $57 million and two cars. The court decided that Sara Cochran needed a permanent conservator.

The appointment of a conservator in most situations has draconian consequences for someone like Ms. Cochran. This means that Ms. Cochran is no longer allowed to make her own decisions about how to spend her money or manage her property because someone else has been appointed to do that for her.

Ms. Cochran appealed the order appointing a conservator for her but the Georgia Court of Appeals affirmed the probate court’s finding. The Court of Appeals pointed out that a conservator was needed in this case because Ms. Cochran’s judgment was impaired by “cognitive loss.” However, that court also made a very important and enlightened observation. The Court of Appeals stated that the fact that Ms. Cochran chose to play those foreign lotteries in and of itself was not clear and convincing evidence that she needed to have a conservator appointed for her. The court opined that “a person of perfectly sound mind, capable of understanding that the lotteries might be a fraud, nev-

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69 The Department of Human Services investigation revealed that she had spent $100,000. Ms. Cochran herself testified that the amount was $600,000 to $700,000. Id. at 491.491 n.1.
70 Id. at 492.
71 See id.
72 Id. at 491-92.
73 Id. at 493.
74 Id.
75 Id.
76 Id. at 495.
77 Id. at 493-94.
ertheless might choose to play the lotteries as escapist fantasy and fun.”

This observation by the court illustrates the conundrum that we as a society must face:

How do we ensure the autonomy, the freedom of choice of older women who want to hoard personal items and give their fortunes to someone other than their families and gamble, while protecting older women like Ms. Cochran, who apparently had lost the ability to make a rational decision about her actions and thus was vulnerable to all of those out there who target women like her?

We as a society are finally paying attention to elder abuse — in particular, elder financial abuse — and that is a great thing. However, I, like Jenny Joseph, would like to issue a warning: we must guard against a tendency to “over-protect.”

I plan today to take a few moments to reflect on the various aspects of the multi-faceted problem of elder financial abuse and then address three questions: 1) What can the law itself do to protect the vulnerable without unnecessarily jeopardizing the autonomy of those who are merely eccentric? 2) What role do lawyers play in this societal balancing act? and 3) What can all of us in this room do to foster an appropriate balance between vulnerability and autonomy?

II. The Elder Population

A. In General

I’ll start by fleshing out the topic I introduced earlier — that is, the composition of today’s society from the point of view of age and gender. Our population is definitely “graying.” By 2030, 20% of the US population will be age 65 and older and the group of Americans who are age 85 and over is the fastest growing demographic group in the US popula-

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78 Id. at 493, 493 n.4 (citing Mary F. Radford, Guardianships and Conservatorships in Georgia, § 5–1, p. 239 (1st ed. 2005).  
79 The author is aware that for some individuals, gambling is not entertainment but rather an addiction. The reasons why many elderly individuals, particularly women, seem prone to this addiction are discussed in Michael Mayerck’s article, Gambling Granny: The Elderly’s Propensity for Gambling Addiction and the Need for Effective Legal and Legislative Remedies to Prevent It, 27 Elder L. J. 187, 197-99 (2019).  
The average life span for an adult in 1950 was 68.2 years. By 2018, the average life span in the United States had increased to 78.7 years, with men having an average life span of about 77 years and women’s average life span being 81 years.

Today’s individuals age 65 and older in fact span three different generations:

- G.I. Generation (whom Tom Brokaw immortalized as "The Greatest Generation") (age 94+)
- Silent Generation (age 75-93)
- Baby Boomers (age 55-74)

The individuals who are part of this older population are wealthier by far than the each of the generations that preceded them. The median household income of households headed by someone age 65 or older has increased dramatically since 1967 — a whopping 130% — and that growth has far outstripped that of younger households. And for the first time in American history, the individuals who have the highest median net worth in our country are those age 75 and older.

These individuals will also bear more responsibility in managing their own wealth in their later lives than did those who preceded them. In prior generations, a typical retiree’s financial life was regulated by regular, defined distributions paid out each month from Social Security and employer-sponsored pension plans. These retirement vehicles left

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little room for flexibility. In other words, the retiree and his or her spouse basically knew that they would be living on a specified, guaranteed monthly distribution, no more and no less. They did not have to make decisions about how to invest their retirement savings nor about how to withdraw those savings over time. The retirees of today and those of the future will be relying increasingly not on defined benefit pension-type plans but on their own accumulations in defined contribution plans, 401(k) plans and Individual Retirement Accounts.\textsuperscript{89} They will be the ones (rather than the government or their employers) who will be making the decisions not only as to how to invest these assets (among an increasingly complex and confusing array of financial products)\textsuperscript{90} but as to when and how much of their retirement assets to withdraw. Unfortunately their nest eggs are viewed by today’s scammers and fraudsters as a virtual pot of gold.

B. Threats to Elders’ Financial Security

Thus the stability and financial security of today’s retirees is inextricably linked with their financial capacity — that is, their “capacity to manage money and financial assets in ways that meet [their] needs and which are consistent with [their] values and self-interest.”\textsuperscript{91} Their financial stability is also linked to their astuteness in protecting themselves from the fraudsters who have them in their cross-hairs. Only in the past decade have researchers focused their attention on the degree to which older adults display this requisite financial capacity.\textsuperscript{92} Their findings are not exactly optimistic. For example, one study showed that financial literacy (that is, knowledge of the basic concepts essential to making effective financial choices) on average declines at a rate of about 2% per year


\textsuperscript{90} Lusardi, supra note 89. See generally Melinda Wenner Moyer, \textit{Why Older Adults are Too Trusting}, \textit{Sci. Am. Mind} (May 1, 2013), https://www.scientificamerican.com/article/why-older-adults-are-too-trusting/ (discussing how elders are susceptible to exploitation).


\textsuperscript{92} “Despite its critical importance in everyday life, financial capacity has been surprisingly neglected in research concerning older adults.” \textit{Id.}
after individuals reach age 60. The same study showed, however, that
individuals’ confidence in their ability to make sound financial decisions
does not decline with age. Talk about a recipe for disaster — one’s
financial ability is reduced but one’s confidence in his or her ability re-
mains intact or even increases. Add to this the finding of a recent Wells
Fargo study that shows that while 98% of the respondents believed that
seniors are susceptible to scams, only one in ten of the older Americans
surveyed believed that this could actually happen to them.

But there is more bad news: In addition to the decrease in financial
capacity, increased confidence, and the refusal to face the potential for
financial abuse, the vulnerability of some older adults may be further
enhanced by an arguably admirable personality trait that appears to in-
crease as we age. The trait is that of being trusting of other people. The
older we get, on average the more trusting we become. This correla-
tion between age and trust seems to bear little relationship to the era or
culture in which we grew up. In a study that examined almost 200,000
people from over 83 countries, “a positive association [was found] be-
tween age and trust . . . that has existed for at least the past 30 years with
little change over time.” A 2013 study published in the Scientific
American found that there actually is a physical reason behind this cor-
relation between aging and a heightened sense of trust. The study iso-
lated an “age-related drop in activity in the anterior insula, a brain
region that may play a role in assessing trust and risk.”

So here is the picture that is shaping up: we wealthy, older Ameri-
cans are living longer than ever before and are handling our own retire-
ment benefits; our financial capacity is lessening over time but we
remain fairly confident in our abilities and that we won’t be scammed;
and we tend over time to become less and less suspicious of the people
around us. So how do you spell “vulnerable”?

And we have not yet even talked about cognitive loss, in the form
of dementia, that is now plaguing many older adults in our society, much
as the Georgia probate court found that it plagued Sara Cochran. The
symptoms of Alzheimer’s Disease, which is the most common cause of

93 Michael Finke et al., Old Age and the Decline in Financial Literacy, 63 MGMT.
94 Id. at 214.
95 2018 Wells Fargo Elder Needs Study, WELLS Fargo, at 1, 8 (2018), https://
96 Julie Deardorff-Northwestern, People ‘Grow to Trust’ As They Get Older, FUTU-
97 Id.
98 Moyer, supra note 90.
99 Alzheimer’s disease (“AD”) is defined by the National Institute on Aging as “an
irreversible, progressive brain disorder that slowly destroys memory and thinking skills
dementia, showed up in some 5.8 million Americans in 2019. Of those individuals, it is estimated that 5.6 million were over age 65. The numbers of Americans living with Alzheimer’s Disease is expected to rise to 14 million by 2050. In addition, other emotional and mental conditions can affect one’s decision-making ability and increase one’s susceptibility and vulnerability. Scientists are now exploring the theory that even the decision-making ability of some otherwise “healthy” elders may be impaired due not to hidden dementia but rather to changes in the frontal lobes of their brains. “[S]tudies using brain imaging suggest that a subset of older adults who have no diagnosable neurological or psychiatric disease may experience disproportionate, age-related decline in specific neural systems crucial for complex decision-making.”

C. Older Women

So again the question is: why are these issues of particular importance to older women? As I mentioned before, older women in our society vastly outnumber older men. The “good news” is that women tend to live, on average, five to six years longer than men. The “bad news” is that the consequences of a longer life may be both unexpected and dire. For example, a Merrill Lynch study on “Women and Financial Wellness” estimates that “the average woman will have 39% higher health costs than the average man in retirement, paying an additional


102 Id.
Almost two-thirds of the sufferers of Alzheimer’s Disease in our country are women.107

Older women, as we’ve seen, also are more likely to be “alone” than older men. This is due to a number of sociological factors that have created a group of people whom some refer to as “elder orphans.”108

What has created this new population group? The life expectancy statistics I quoted obviously play a part. In addition, of the approximately 800,000 people who lose a spouse to death each year, about 700,000 of them were women.109 The divorce rate for people age 50 and older doubled between 1990 and 2010 and the divorce rate for people age 65 and older tripled during that time even though the divorce rate levelled off and went down in the younger population.110 Although many of these divorced individuals remarry, research has revealed a gender gap in that women are less likely to remarry than men.111 Another factor that affects women’s solo status later in life is that fewer women in the Baby Boom generation chose to be mothers than in the generations that preceded them. The number of women who were childless at the end of their child-bearing years doubled between the 1970s and 2010.112 Adding to these phenomena the fact that there are significant numbers of

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108 “[E]lder orphans [are defined as] aged, community-dwelling individuals who are socially and/or physically isolated and have no known family member or designated surrogate available to them.” Maria T. Carney et al., Elder Orphans Hiding in Plain Sight: A Growing Vulnerable Population, CURRENT GERONTOLOGY & GERIATRIC RES. § 1 (July 12, 2016), https://www.hindawi.com/journals/cggr/2016/4723250/.
112 Gretchen Livingston & D’Vera Cohn, Childlessness Up Among All Women: Down Among Women with Advanced Degrees, PEW RES. CTR. (June 25, 2010), http://
individuals who have outlived\textsuperscript{113} or are estranged from their children, one researcher concluded that about 22.6\% of the population is at risk of becoming an “elder orphan.”\textsuperscript{114} Those who are living alone without social or family support face increased threats to their independence as well as to their health. They are also often the targets of those in our society who prey on vulnerable adults: the perpetrators of elder abuse. And again, women figure prominently in this group. The typical victim of elder abuse is often described as “between the ages of 70 and 89, white, female, frail and cognitively impaired. She is trusting of others and may be lonely or isolated.”\textsuperscript{115}

III. ELD ER FINANCIAL ABUSE

So this brings us to zero in on the depressing topic of elder abuse — in particular elder financial abuse or, as it is sometimes called, elder financial exploitation. A 2009 report pointed out that “[i]n two-thirds of reports [of elder abuse] to Adult Protective Services, the victim is an older or disabled woman.”\textsuperscript{116} This same report stated that “people with dementia are at greater risk of elder abuse than those without.”\textsuperscript{117} (Remember the statistic that 2/3 of those with Alzheimer’s disease are women?) Social isolation is also often cited as a risk factor for elder abuse.\textsuperscript{118} (Remember our “elder orphans” statistic?) So we have a perfect storm — women who are alone and isolated, vulnerable due to cognitive loss, and trusting by nature versus the vast array of perpetrators in our society.

\textsuperscript{113} Carney et al., supra note 108, § 3.2.3.

\textsuperscript{114} Id. The same study found, however, that a much smaller percent of the population actually are currently “elder orphans.”


\textsuperscript{117} Id. at 4.

A. What is Elder Financial Abuse?

What is elder financial abuse? There is no one legal or societal definition but it generally means the use or misuse of an elder person’s property without his or her consent. Elder financial abuse can take a variety of forms. It can be as simple as the pilfering of small amounts of cash by an in-home caregiver, who maybe keeps the change after she makes a grocery purchase. It can take the form of forgery or unduly influencing the elder individual to sign a trust or will or a power of attorney. It can, as in Ms. Cochran’s case, take the form of fraud and scams perpetrated by outsiders, such as:

- the lottery winnings I mentioned that can be collected only upon the prepayments of certain sums for taxes;
- the phony call from the IRS or the Medicare authorities asking for Social Security numbers and other identifying information;
- the website that advertises cheap prescription drugs or supplements that are in fact contaminated or contain the wrong

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119 For example, the Older Americans Act of 2006 defines “exploitation” as “the fraudulent or otherwise illegal, unauthorized, or improper act or process of an individual, including a caregiver or fiduciary, that uses the resources of an elder for monetary or personal benefit, profit, or gain, or that results in depriving an elder of rightful access to, or use of, benefits, resources, belongings, or assets.” Older Americans Act, Pub. L. 109-365, 120 Stat. 2522, 2524 (2006) (amending 42 U.S.C. § 3002(24)(A) to include this definition). The National Adult Protective Services Association describes elder financial exploitation as follows:

Financial exploitation occurs when a person misuses or takes the assets of a vulnerable adult for his/her own personal benefit. This frequently occurs without the explicit knowledge or consent of a senior or disabled adult, depriving him/her of vital financial resources for his/her personal needs.


ingredients or simply have not been proven to do what they are said to do;\textsuperscript{123}
\begin{itemize}
\item the fake charity solicitation done by phone\textsuperscript{124} (how many elders still have land lines, compared to their younger counterparts?);
\item the purported creditor who calls the grieving widow (after reading the obituary) to claim that her deceased husband owed him money\textsuperscript{125};
\item the warning that pops up on the computer screen offering “tech support” to cure a non-existent virus\textsuperscript{126};
\end{itemize}

The Federal Bureau of Investigation reports that, in 2017 alone, “almost 50,000 people over the age of 60 lost $342.5 million” just “to internet fraud and scams.”\textsuperscript{127} National reports indicate that older individuals lose somewhere between $2.9 billion\textsuperscript{128} and $36.48 billion\textsuperscript{129} each year due to elder financial abuse. Even more staggering is the realization that these reports are reflecting only the tip of the iceberg. Recent estimates indicate that only one in fourteen cases of financial abuse are ever reported.\textsuperscript{130}

Two scams to which the elderly individuals seem especially susceptible are the grandparent scam and the sweetheart scam. The perpetrator of the grandparent scams often mines enough information from a grandchild’s social media to weave a credible story before he makes a phone call to the targeted grandparent. The scammer then poses either

\textsuperscript{124} See Before Giving to Charity, FED. TRADE COMM’N (Mar. 2019), https://www.consumer.ftc.gov/articles/0074-giving-charity (acknowledging that sham charities exist and providing steps individuals can employ to protect themselves).
\textsuperscript{125} See, e.g., Katie Pelton, Call for Action Alert: Scammers target grieving widow, KKTV 11 (Jul. 1, 2019 1:33 PM), https://www.kktv.com/content/news/Call-for-Action-Alert-Scammers-target-grieving-widow-512070141.html (describing an incident of a grieving widow who was called repeatedly).
\textsuperscript{130} Blancato, supra note 127.
as the grandchild himself or a lawyer or law enforcement official who needs money in order to bail out the grandchild from some unfortunate situation.131 (Because many banks have become suspicious of cash withdrawals, these scammers are now demanding their payments in the form of gift cards!)132

The sweetheart scam involves the slow grooming of the target, perhaps beginning with an online dating site.133 These scammers often send online pictures of themselves that bear little or no resemblance to their actual physical appearance.134 (In this respect perhaps the sweetheart scam is not that different than online dating in general?) The “grooming” leads to increased expressions of romantic love and sometimes (as discussed in an ACTEC Elder Law Committee meeting) even marriage.135 But then a “catastrophe” in the new lover’s life occurs that requires a loan or perhaps even a gift of money from the target.136 The end result is not only financial loss (in some reported cases as high as $500,000137 or even $2 million138) but also shame, humiliation, and heartbreak.139

135 Ellen McKissock & Christopher Long, Marrying Into Elder Abuse, presented at the Elder Law Committee meeting at the ACTEC Annual Meeting, March 22, 2019.
B. Victims of Elder Financial Abuse

Who are the victims of elder financial abuse? As I mentioned before, there are certain factors that appear repeatedly in elder financial abuse situations. Prominent among these are the fact that the elder suffers from some cognitive impairment, is too trusting of or not suspicious enough of others, is dependent upon others for care, is socially isolated, and is lonely. This description might lull many or all of us in this room into thinking that we are immune. But wait: there is another group of victims who should not be ignored. These are sometimes referred to as the “high achievers” 140 who are suffering from some cognitive or decision-making impairment. High achievers are very attractive targets of scammers and fraudsters for the obvious reason that their achievements have been rewarded by the accumulation of a significant amount of wealth. 141 It may be less apparent to the outside world when a high achiever has become vulnerable or susceptible to exploitation because high achievers often exhibit something called “reserved capacity.” 142 In other words, they “can still operate at a reasonable level when they become cognitively impaired — often at a level that masks the true severity of their impairment.” 143 Consequently their vulnerability may not be as readily seen as it is with some other older individuals. Finally, high achievers “are characteristically proud people who do not take their declining mental abilities sitting down.” 144 They reject the notion that they may be helpless and thus often refuse to let family members or professionals intervene in potentially abusive situations. 145

C. Perpetrators of Elder Financial Abuse

Who are the perpetrators of elder financial abuse? Obviously there are the strangers, often located in different countries, who are difficult to apprehend because they exist primarily in the amorphous world of the internet and the cloud. 146 But, sadly, many of these perpetrators are closer to home. They are the trusted advisors of the elders — their lawyers, accountants, financial advisors — their caregivers, and, all too often (as with Brooke Astor), even members of their own families. The

141 Id.
142 Id.
143 Id.
144 Id.
145 Id.
seminal 2011 MetLife Study of Elder Financial Abuse reported that 34 percent of noted incidents were perpetrated “by family and friends.”147 “The National Center on Elder Abuse reports a much higher estimate, with 57.9 percent of perpetrators of financial exploitation of older adults being family members, 16.9 percent being friends and neighbors and 14.9 percent being home care aides.”148

Studies have isolated certain characteristics that are exhibited by those family members and caretakers who engage in financial abuse. Included among these risk factors are drug or alcohol addiction, mental health issues, gambling or related behavioral problems, financial problems, unemployment, and a heightened sense of entitlement on the part of a child.149

Perhaps not surprisingly, the closer the relationship is between the elder victim and the perpetrator, the less likely it is that the abuse will be reported and that the perpetrator will be prosecuted. Why? Sometimes this is because the victims are simply too embarrassed to report or prosecute. Other times the victims themselves are not absolutely certain that the abuse took place at all (due to their own cognitive impairment) or that what took place was in fact “abuse.”150 For example, was it abusive for a struggling son with a wife and new baby to convince his mother to buy his family a home and a nice new car? Some victims fear further abuse151 or that the individual on whom they are dependent will abandon them.152 Some victims feel that at some level their children may be entitled to the money or property that they appropriated, perhaps due to some lingering guilt about not giving the child the appropriate amount of love and affection in that child’s youth. Other victims may simply not want to air their family’s dirty laundry or, God forbid, be responsible for sending a family member to jail.153 Finally, and perhaps saddest of all, many victims realistically comprehend that the “remedy” for the abuse may be worse than the harm. In other words, they fear

147 The MetLife Study, supra note 128, at 10.
152 Dessin, supra note 150, at 209-10.
153 Niedermayer, supra note 146.
(and it is a realistic fear) that revealing their own victimization will cause other family members or protective services workers to move them — the victims — to an institution or to proceed to deprive them of virtually all their civil rights by having a guardian appointed for them.\textsuperscript{154} With what other crime in our country does reporting and prosecution carry such a tremendous risk to the victim of losing her own autonomy?

D. State and Federal Initiatives

As I mentioned earlier, our society is waking up to the reality of elder financial abuse and has rallied around protecting vulnerable and elder adults.

Consider, for example, the following statutes and initiatives that have taken place on a national level:

1) The Senior Safe Act of 2018\textsuperscript{155} encourages financial institution employees and advisors to report suspected elder financial abuse by immunizing them from liability for reporting so long as they provide appropriate training to their employees.

2) The Elder Abuse Prevention & Prosecution Act of 2017\textsuperscript{156} calls for a coordinated effort by several federal government departments to help curb elder abuse, including the appointment of one U.S. Assistant Attorney in every federal judicial circuit to serve as that district’s Elder Justice Coordinator.

3) In February 2018, and again in March 2019, the Department of Justice’s Elder Fraud Sweeps resulted in the charging of some 450 defendants who had allegedly defrauded over three million elders of over $1.5 billion dollars in losses using phony computer security alerts.\textsuperscript{157}


4) The U.S. Senate Special Commission on Aging (chaired by Senator Susan Collins of Maine, age 66) held hearings in January 2019 on Fighting Elder Fraud.\footnote{Fighting Elder Fraud: Progress Made, Work to be Done, U.S. SENATE SPECIAL COMMITTEE ON AGING (Jan. 16, 2019, 9:30 AM), https://www.aging.senate.gov/hearings/fighting-elder-fraud-progress-made-work-to-be-done.}

5) In February 2019, the Seniors Fraud Prevention Act, which is designed to crack down on frauds perpetrated on elder Americans, was re-introduced as a bipartisan effort by Senators Collins and Amy Klobuchar (age 58).\footnote{Seniors Fraud Prevention Act of 2019, S. 512, 116th Cong. (2019); see Collins, Klobuchar Introduce Legislation to Crack Down on Fraud Targeted at Seniors, SUSAN COLLINS: UNITED STATES SENATOR FOR MAINE (Feb. 19, 2019), https://www.collins.senate.gov/newsroom/collins-klobuchar-introduce-bipartisan-legislation-crack-down-fraud-targeted-seniors.}

In addition to the national initiatives, state legislatures are responding resoundingly to the problem of the abuse of elder and vulnerable adults. Virtually every state has enacted statutes that require certain individuals who suspect that abuse of an elderly or vulnerable adult is occurring to report their suspicions to the local adult protective services agency.\footnote{A. Kimberley Dayton et al., Advising the Elderly Client § 4A:20, § 23:48 (2019).} In addition to the reporting statutes, some states have criminal statutes that directly or indirectly address abuse of elderly and vulnerable citizens.\footnote{See, e.g., Ala. Code §§ 13A-6-192 to -94 (2020); Colo. Rev. Stat. § 18-6.5-103 (2020); D.C. Code §§ 22-933, 22-933.01 (2020); Ga. Code Ann. § 16-5-100 (2020); Va. Code Ann. § 18.2-369 (2020).} Some of these statutes provide for explicit enhanced penalties for crimes that are committed against elder or vulnerable persons.\footnote{See, e.g., Cal. Penal Code § 368 (2020); Ind. Code § 35-46-1-12 (2020).} Others criminalize behavior that is otherwise not deemed criminal (such as “undue influence”) if the behavior is inflicted on an elder or vulnerable adult.\footnote{See, e.g., Ga. Code Ann. § 16-5-100(6); Kan. Stat. Ann. § 21-5417(a)(2)(A) (2020); Md. Code Ann., Crim. Law § 8-801 (LexisNexis 2020).}

These initiatives are laudable in that they rightfully prioritize the safety and security of elder persons. However, they also bring with them some more subtle concerns. They run the risk of stereotyping all elders as weak, fragile, confused, and vulnerable. They may not always be effective. And they may even have the unintended consequence of jeopardizing the autonomy of an individual who does not need their protection.
IV. THE QUESTION OF BALANCE

So this brings us back to the challenging question of balance: how do we protect our grandmothers (and grandfathers) from predation while at the same time respecting and guarding their autonomy? In other words, what if Granny's cognitive abilities are not reduced and she can afford it and she really and truly just wants to gamble?

A. Protecting Autonomy

Before discussing how to reach this balance, it is worth addressing a preliminary question: Why should we protect Granny's autonomy? For purposes of this presentation I will define autonomy as the freedom to pursue one's own life choices without forced intervention by others, whether private parties or governmental officials, even if those choices are ones that the rest of us find inadvisable or ill-considered or just downright stupid. It is perhaps easier to define autonomy by describing what happens when one is deprived of her autonomy. For older adults, this can occur either by private action (e.g., the family decides to move Granny to a nursing home) or by government action — that is, when Granny is placed under guardianship or conservatorship. What happens when Granny is moved to a nursing home? Up until very recently she lost such basic rights as the right to decide when she wanted to eat, what she wanted to eat and even whether she could lock the door to her room. (I am happy to report that recent regulations issued by the Center for Medicare and Medicaid Services now guarantee some of these rights to many nursing home residents.)¹⁶⁴ What happens if a guardian or conservator is appointed for Granny? A quick look at any state's Guardianship Code produces a list of the rights that she will lose: among other things, she will lose the right and power to (1) get married; (2) consent to medical treatment; and (3) decide where she wants to live.¹⁶⁵ Furthermore, if a conservator (guardian of the property) is appointed for Granny, she also will lose the right to make contracts, to buy and sell her own property and to conduct business transactions — basically, to handle any of her tangible or intangible property.¹⁶⁶ In other words, she cannot buy the clothes she wants to buy, take the trips she wants to take, or play the games she wants to play (except maybe Bingo).

¹⁶⁴ Effective since 2016, 42 C.F.R. § 483.60 requires that nursing home residents be furnished with “palatable, attractive” food and drink and with “suitable, nourishing alternative meals and snacks” if they choose to eat outside of scheduled meal times. Enacted in 2014, 42 C.F.R. § 401.301(c) guarantees that each nursing home resident will have a “person-centered service plan” and is entitled to units that can be locked by the residents.
¹⁶⁵ See, e.g., Ga. Code Ann. § 29-4-21(a).
The loss of autonomy equates to the loss of control. Loss of control in the form of loss of personal independence is philosophically the antithesis of one of the most valuable and deeply-embedded rights in our culture. In addition, loss of control has been proven to have a tangible negative effect on an individual’s psychological and even physical well-being.\footnote{See Nina A. Kohn, Elder Empowerment as a Strategy for Curbing the Hidden Abuses of Durable Powers of Attorney, 59 Rutgers L. Rev. 1, 27-29 (2006).} Studies of institutionalized patients have shown that patients who are given a sense of responsibility and choice in their daily lives exhibit greater activity, more happiness, increased interpersonal action, and significant improvements in their health as opposed to their counterparts who are restricted to doing only what they are “allowed” to do.\footnote{Id. at 27-28. Jessica Flanigan, Respect Patients' Choices to Self-Medicate, CATO Unbound (July 10, 2017), https://www.cato-unbound.org/2017/07/10/jessica-flanigan/respect-patients-choices-self-medicate.} Just as we know that individuals who are victims of elder abuse suffer both physically and psychologically, so too do individuals who have lost their personal autonomy. As one researcher reports, “When people think they have little or no control in their lives, they may stop doing some of the everyday things that are important for self-care — because they believe those things don’t matter.”\footnote{Robert Preidt, What Makes Seniors Feel In Control?, Dahl’s Pharmacy (Feb. 8, 2019), https://dahlspharmacy.com/patient-resources/article_modal/742137/what-makes-seniors-feel-in-control (statement of Dr. Shevaun Neupert). Dr. Neupert is a co-author of the study entitled “Predicting Control Beliefs in Older Adults: A Micro longitudinal Study,” published in The Journals of Gerontology: Series B on January 12, 2019, available at https://academic.oup.com/psychsocgerontology/advance-article/doi/10.1093/geronb/gbz001/5288507.}

I have a few modest suggestions (and I stress the word “modest”) for achieving the balance between maximizing the protection of vulnerable older adults without needlessly sacrificing the precious autonomy of those who do not need our protection. My suggestions fall into the three categories of questions that I mentioned earlier: What the law itself can do to achieve this balance, what lawyers can do, and what each of us as individuals can do.

B. What Can the Law Do?

Question #1: What can the law do? Let’s begin by taking a closer look at the ramifications and potential unexpected consequences of today’s push to use government intervention and law enforcement to stave off the epidemic of elder financial abuse.
1. Mandatory Reporting Laws

First there are the reporting laws.170 As I mentioned, these laws require certain individuals (called “mandatory reporters”) to report suspected elder abuse to the state’s Adult Protective Services171 unit or other appropriate government authority. Mandatory reporters vary from state to state but may include physicians,172 mental health professionals,173 pharmacists,174 clergy members,175 and, in some states, even lawyers.176 Upon receiving a report, the state’s Adult Protective Services conducts an investigation and recommends a plan of action, which may include bringing in law enforcement.177

These laws are modeled after state child abuse reporting laws.178 There is certainly merit in promoting the reporting of abuses and crimes

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170 Every state has some form of elder abuse reporting law. STETSON L. CTR. FOR EXCELLENCE IN ELDER L., https://www.stetson.edu/law/academics/elder/home/media/Mandatory-reporting-Statutes-for-elder-abuse-2016.pdf (providing a compilation of states’ elder abuse reporting statutes).

171 “Adult Protective Services” has been described as “a social services program provided by state and/or local governments nationwide serving older adults and adults with disabilities who are in need of assistance.” NAT’L ADULT PROTECTIVE SERV. ASS’N, https://www.napsa-now.org/get-help/how-aps-helps/ (last visited May 5, 2020). Forms of abuse may include physical, emotional, verbal, and sexual abuse. Exploitation can be either financial or material in nature. Neglect can be caused by either a caregiver or can be an individual’s inability to care for themselves due to physical or cognitive impairments. See id. “Interventions provided by Adult Protective Services include, but are not limited to, receiving reports of adult abuse, exploitation or neglect, investigating these reports, case planning, monitoring and evaluation. In addition to casework services, Adult Protection may provide or arrange for the provision of medical, social, economic, legal, housing, law enforcement or other protective, emergency or supportive services.” Adult Protective Services, NAT’L CTR. ON ELDER ABUSE, https://ncea.acl.gov/What-We-Do/Practice/Intervention-Partners/APS-(1).aspx (last visited May 5, 2020) (hereinafter NCEA, Adult Protective Services). For an overview of the development of adult protective services in the United States, see Nina A. Kohn, Second Childhood: What Child Protection Systems Can Teach Elder Protection Systems, 14 STAN. L. & POL’Y REV. 175, 182-84 (2003).


173 See, e.g., ARK. CODE ANN. § 12-12-1708 (2020).

174 See, e.g., COLO. REV. STAT. § 18-6.5-108 (2020).

175 See, e.g., CONN. GEN. STAT. § 17a-412 (2020).

176 See, e.g., ARIZ. REV. STAT. ANN. § 46-454 (2020).

177 NCEA, Adult Protective Services, supra note 171. A 2013 study of 71 cases of elder abuse found that law enforcement was involved in 54% of the cases. Shelly L. Jackson & Thomas L. Hafemeister, How Do Abused Elderly Persons and Their Adult Protective Services Caseworkers View Law Enforcement Involvement and Criminal Prosecution, and What Impact Do These Views Have on Case Processing? 25 J. ELDER ABUSE & NUBLECT 254 (2013).

that still remain largely “hidden” from our society. The underlying presumption\(^{179}\) of this type of law is that the victim will not report because she is incapacitated or too vulnerable or essentially unable to take action to protect herself. As already noted, older individuals are often perceived as vulnerable, feeble, and in need of protection. For older women, this perception is exacerbated by the widespread stereotyping of women as “the weaker sex.” The government justifies its intervention into the lives of these individuals under the theory of *parens patriae*, which is the notion that the state is the “parent” of all its citizens and thus should act when necessary to protect those who are unable to protect themselves.\(^{180}\) The key concept underlying the *parens patriae* doctrine is the protection of vulnerable individuals. However, many of the state mandatory reporting laws focus not on vulnerability but on status. In other words, in many states, the mere fact that an individual has reached a certain age (often age 60 or 65) results in that individual’s activities being subject to the reporting laws.\(^{181}\) These laws assume that age and vulnerability are inextricably entwined.

These laws infantilize and objectify older individuals.\(^{182}\) They assume that all elders are in need of this well-meaning governmental protection. And the price that the elders pay for falling into this undifferentiated class of older individuals could well be unwarranted in-

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\(^{180}\) “The state regarded as a sovereign; the state in its capacity as provider of protection to those unable to care for themselves.” *Parens Patriae*, BLACK'S LAW DICTIONARY (10th ed. 2014) (second definition).

\(^{181}\) For example, COLO. REV. STAT. § 18-6.5-102(2) (2020) includes in the definition of “at-risk adult” (for whom reporting is required) “any person who is seventy years of age or older;” CONN. GEN. STAT. § 17b-450(1) (2020) defines an “elderly person” (for whom reporting is required) as “any resident of Connecticut who is sixty years of age or older;” GA. CODE ANN. § 30-5-3(6) (2020) defines “elder person” (for whom reporting is required) as “a person 65 years of age or older.” It should be noted that some state statutes do not blatantly pronounce that individuals of a certain age are in need of protection, but rather reach that result in a bit more round-about way. For example, South Carolina defines a “vulnerable adult” as “a person eighteen years of age or older who has a physical or mental condition which substantially impairs the person from adequately providing for his or her own care or protection. This includes a person who is impaired in the ability to adequately provide for the person’s own care or protection because of the infirmities of aging including, but not limited to, organic brain damage, advanced age, and physical, mental, or emotional dysfunction.” S.C. CODE ANN. § 43-35-10(11) (2020) (emphasis added). See Pomerance, supra note 179, at 475 (listing of these statutes).

\(^{182}\) See Kohn, supra note 178, at 1065-67 (describing the varying criticisms of mandatory reporting laws and adding Professor Kohn’s own rights-based critique).
tervention by the state into their private sphere of existence.183 Simply put, under the laws of some states, I, Mary, at age 64, can “make up for the sobriety of my youth”184 by perhaps lending inappropriate amounts of money to my adult son who is down on his luck, or, better still, buying extravagant presents for my new boyfriend. However, if I wait a few more months until my 65th birthday, my doctor, my psychologist, my pastor, and in some states even my attorney are required to report me to APS if my actions give any of these individuals “cause to believe” that I am being exploited.185 What might be the unintended consequences of such a statute? I, at age 65, knowing that my judgement will be questioned (and perhaps even ridiculed) and that a well-meaning but overly protective APS agent may soon be knocking at my door, may choose to stop going to my doctor, stop talking with my therapist, stop seeking counseling at my church, and even stop confiding in my lawyer. With this in mind, my first suggestion is that the reporting statutes should stop using age per se as a proxy for vulnerability.186 There are statutes in some states that do not have an age component in their reporting and criminal statutes.187 They use terms such as “vulnerable adult” and indeed the modern trend is to include not only those who are “elderly” but also all vulnerable individuals who are over the age of 18.188

2. Criminal Statutes

The other type of state elder abuse statutes — the criminal statutes — are not as effective as they could be because some of them allow “stranger perpetrators” (such as those scammers and fraudsters who victimized Sara Cochran) to use their very anonymity to absolve them from guilt under the statute. For example, a District of Columbia statute en-

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183 In a section of his article entitled “Preventing Legalized Ageism,” author Benjamin Pomerance offers a detailed criticism of the statutes that define the protected person on the basis of age alone. Pomerance, supra note 179, at 474-82.

184 See Joseph, supra note 1.

185 For example, Tex. Hum. Res. Code Ann. § 48.051 (West 2019) provides in part that “a person having cause to believe that an elderly person, a person with a disability, or an individual receiving services from a provider as described by Subchapter F is in the state of abuse, neglect, or exploitation shall report the information required by Subsection (d) immediately to the department.”

186 This solution is suggested and explored in Pomerance, supra note 179, at 478-80.

187 See, e.g., Arizona’s mandatory reporting statute, Ariz. Rev. Stat. Ann. § 46-454 (2020), which applies only to a “vulnerable adult” who is defined in Ariz. Rev. Stat. Ann. § 46-451(A)(10) as “an individual who is eighteen years of age or older and who is unable to protect himself from abuse, neglect or exploitation by others because of a physical or mental impairment.”

hances the criminal penalties for many crimes (such as fraud, theft, identity theft, and financial exploitation) if they are committed against an individual who is age 65 or over. However, this same statute states that, “It is an affirmative defense that the accused . . . could not have known or determined the age of the victim because of the manner in which the offense was committed.” 189 So, the end result of these statutes is that fraudsters and scammers like the purveyors of the “Sweet Steaks of Australia,” who contact their victims via the internet, are immunized from these enhanced penalties by virtue of their “excuse” that there is no way they could have known that one or more of the victims they caught in their net of deceit was an older, vulnerable person. My second proposal is that these statutes should not immunize the criminal simply because he did not know or have reason to know that his victim was of that age. 190 In other words, if a scammer sends out messages informing countless individuals that they have won the “Sweet Steaks of Australia” and the individual who responds to this message and sends him a check to cover “taxes” happens to be over age 65, the scammer should not be subjected to a lesser penalty under the defense that he had no way of knowing her age. He ran that risk when he engaged in the scam in the first place.

3. Suggested Alternative to Prosecution

A third refinement that I would like to see added to the law is the introduction of a “kindler, gentler” way of dealing with financial abuse that is perpetrated by individuals who are known to and close to the victim. As I mentioned before, one of the biggest problems in curtailing this type of abuse is that the victim chooses not to report, either out of embarrassment or family pride or a perhaps ill-advised but very real desire to protect the perpetrator. If the only options under our law are having Adult Protective Services intervene or, worse still, having the perpetrator arrested, many of these home-grown varieties of elder financial abuse will remain undisclosed. So what are the alternatives here? One possibility is a form of mediation or “intermediation,” in which a neutral facilitator would work together with the entire family or with the victim’s support group to bring the problem out into the open and explore solutions that are less draconian than institutionalizing the

189 D.C. CODE § 22-3601(c) (2020).
190 In this respect, these laws would be similar to those criminalizing statutory rape in which the perpetrator is not required to know that the victim is underage. For a discussion of the evolution of Florida’s elder abuse criminal statute (such that it no longer requires the prosecution to show that the perpetrator knew the victim was over age 65), see Tracy L. Kramer, Section 784.08 of the Florida Statutes: A Necessary Tool to Combat Elder Abuse and Victimization, 19 NOVA L. REV. 735 (1995).
victim or having a guardianship imposed or incarcerating the perpetra-
tor. This type of “elder mediation” is already happening in some parts of
the globe. The Association for Conflict Resolution has developed a pro-
tocol for “Eldercaring Coordination,” which is mediation that is de-
signed to promote the autonomy of an elder person while at the same
time monitoring situations in which there is a high risk of abuse or neg-
lect.191 A 2015 set of surveys in Australia revealed that 59% of those
who had used mediation to address potential financial abuse of an older
person by a family member felt that “mediation had assisted in prevent-
ing or stopping financial abuse.”192 Like so many other family situations
we encounter in estate planning, elder financial abuse that is perpe-
trated by family members or trusted caretakers is a complex and many-
faceted matter that reflects long-term family tensions as well as current
states of need and states of mind. Mediation allows for nuanced ap-
proaches to dealing with the tensions involved with these family dynam-
ic. Mediation offers an arena in which these tensions can be explored
and perhaps diffused or at least mitigated. Mediation could also offer a
“safe space” in which the elder victim could protect herself while still
preserving the family relationships that are so important to her. Finally,
mediation is founded upon the principle of “self-determination.” In a
mediation, the parties (and, in these cases, the victim would be one of
the “parties”) are encouraged to reach their own resolutions on their
own terms rather than resorting to a court or other outside authority to
tell them what to do.193 So in its own unique way, mediation could tran-
scend the autonomy/vulnerability dichotomy by enhancing the ability of
the adult (with appropriate representation, if necessary) to participate in
her own protection.

4. Revision of Guardianship Laws

State guardianship laws can also offer a more refined way to offer
protection to a vulnerable adult without depriving her completely of all
of her civil and personal rights. In 2017, the Uniform Law Commission,

191 Guidelines for Eldercaring Coordination, Ass’n for Conflict Resolution
lines%20for%20Elder%20Caring%20Coordination%202014.ashx.

192 Bagshaw et al., supra note 149, at 473. This type of mediation could be facilitated
by mediators who are specially trained in such pertinent areas as the psychological dy-
namics of aging, the risk factors for intra-family financial abuse, the assessment of capac-
ity, and the ability to balance family dynamics. Id. at 461-62.

193 The concept of mediation being grounded in self-determination is discussed in
Mary F. Radford, Is the Use of Mediation Appropriate in Adult Guardianship Cases?, 31
under the leadership of ACTEC Academic Fellow David English and with the participation of other ACTEC Fellows such as Molly Ackerly, Debbie Tedford, and Linda Whitton, promulgated the Uniform Guardianship, Conservatorship, and Other Protective Arrangements Act. This revised and modernized Guardianship Act stresses the importance of involving vulnerable individuals in making decisions about their own welfare. Article 5 of the Act permits a court to eschew a full-blown guardianship (with its accompanying loss of rights to the individual) in favor of a less intrusive alternative “that is precisely tailored to the individual’s circumstances and needs, and that is limited in scope and, potentially, duration.” Under this Act, if (for example) a house-bound grandmother is being victimized by a caretaking grandchild on whom she also is dependent for meeting her daily needs, a court may explore other possibilities for having those needs met that may override the requirement to have that grandchild so intricately involved in the grandmother’s life and her finances. Even if the grandchild had been appointed as her grandmother’s guardian, this Act would provide for increased monitoring of the guardianship by the court, prevent the grandchild from isolating Granny from other family members and friends, and promote Granny’s ability to retain her independent decision-making ability whenever possible.

194 Professor David M. English, University of Missouri School of Law, served as the Chair of the Drafting Committee on the Uniform Guardianship, Conservatorship, and Other Protective Arrangements Act (UGCOPAA).

195 UNIF. GUARDIANSHIP, CONSERVATORSHIP, & OTHER PROTECTIVE ARRANGEMENTS ACT (UNIF. LAW COMM’N, 2017).

196 See id., Prefatory note at p. 2 (explaining that the new provisions require individuals subject to guardianship be given meaningful notice of their rights and are required to be involved in decisions about their lives and life planning).

197 Id. § 501 cmt.

198 Under section 502(b)(2) of the UGCOPAA, instead of imposing a guardianship, a court may “restrict access to the respondent by a specified person whose access places the respondent at serious risk of physical, psychological, or financial harm” and, under section 503(c)(1), instead of ordering a conservatorship, a court may “authorize or direct a transaction necessary to protect the financial interest or property of the respondent . . . .”

199 Id. § 317.

200 UGCOPAA section 315(c) provides, “A guardian for an adult may not restrict the ability of the adult to communicate, visit, or interact with others, including receiving visitors and making or receiving telephone calls, personal mail, or electronic communications, including through social media, or participating in social activities . . . .”

201 Section 313(b) of the Act requires a guardian to “promote the self-determination of the adult and, to the extent reasonably feasible, encourage the adult to participate in decisions, act on the adult’s own behalf, and develop or regain the capacity to manage the adult’s personal affairs.”
C. What Can Lawyers and Other Professionals Do?

Question #2: What can we lawyers and other allied professionals do to help guard this delicate balance between autonomy and protection? In our roles as estate planners and elder law attorneys, we often will find ourselves on the front line of the battle against elder financial abuse. In addition we may find ourselves as arbiters of the tension between autonomy and vulnerability. We need to educate ourselves about the risk factors for elder financial abuse and not be shy about discussing these factors with our clients. We should perhaps consider putting together our own set of screening questions to be used with both new and existing clients.

1. Care in Document Drafting

In addition, much of the elder financial abuse that is committed by those close to the victim is accomplished through the use of legal vehicles that lawyers prepare, such as wills and trusts and powers of attorney and deeds for joint ownership of property. We are sometimes asked to draft one of those documents by someone other than the actual testator or transferor. We should resist the urge ever to draft documents for anyone other than the principal. So, even if a longtime trusted client asks us to whip up a “simple will” for her mother, we should never do so without meeting and consulting with the mother first.202 (I realize that I am preaching to the choir on this topic.)

2. Increased Self-Education about Capacity

Next, we professionals must ramp up our understanding of legal and mental capacity and of the tests performed to assess it.203 If a client has received a diagnosis of progressive dementia, we must be quick to help her put into place mechanisms that will allow for the management of her person and property when she is unable to do so. And these mechanisms should not be simple, garden-variety powers of attorney or trusts but rather mechanisms with back-up protections (such as a trust

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202 The second edition of the NAELA Aspirational Standards introduces the notion of the “protected individual” who exists in many attorney-client relationships. This is the individual “whose personal and property interests are the subject of the representation.” This individual may or may not be the actual client as she may lack the capacity to enter into the relationship or may be represented by a fiduciary, such as a guardian or agent under a power of attorney. Nat’l Acad. of Elder L. Att’ys, Aspirational Standards for the Practice of Elder and Special Needs Law With Commentaries, NAELA J. (Special Ed. 1, 7-8 (2018).

protector or a family oversight committee) that will help guard against abuse by the major power-holder as well as by outsiders.

3. **Refinement of Professional Responsibility Rules**

As lawyers we also should demand more clarity from the American Bar Association, our state bars, and our state legislatures as to how we should deal with our clients whose capacity is diminishing. Model Rule of Professional Conduct 1.14, which is entitled “Client with Diminished Capacity,” is unsatisfactory in its current form. It basically says that we should maintain a “normal” client-attorney relationship with a client whose capacity is diminished unless we can’t, in which case we may take protective action. This simplistic, dualistic command ignores the many calibrations that exist between the time a client has full capacity and the time that capacity is completely gone. Importantly, this Rule does not address the issue of “vulnerability” or “susceptibility” to elder abuse. Even clients who are operating at a high level of capacity may be vulnerable to the wiles of an abuser. The widow who is grieving the loss of her long-time spouse may be easily targeted by the scammer who reads the obituaries and shows up to demand money that was putatively owed to him by her husband. The accident victim who needs expensive pain medication may not comprehend that mail-order companies that promise cheap drug prices are sometimes selling medications that are either ineffective or, even worse, dangerous. The Model Rules give us no guidance for dealing with our clients who still have capacity but whose susceptibility is heightened and whose decision-making ability and judgment are marred by external forces.

We must also demand of our state bars and state legislatures more clarity as to how we as lawyers should deal with reporting suspected elder abuse. Remember the mandatory reporting statutes that I mentioned earlier? Some states include lawyers on the list of those who are required to report suspected elder abuse.²⁰⁴ This is a direct assault on one of the hallmarks of the client-attorney relationship: that of client confidentiality, and such a requirement could discourage vulnerable individuals from confiding in their lawyers. We should lobby to have lawyers removed from those statutes that name us as mandatory reporters.

At the same time, we lawyers should have the discretion to take action if we suspect that our clients are endangered without fear of being subjected to professional disciplinary action. The state of Illinois, for example, provides by statute that any person may report suspected elder abuse and that a person who reports in the good faith belief that the

²⁰⁴ See, e.g., ARIZ. REV. STAT. ANN. § 46-454(B) (2020); see also TEX. HUM. RES. CODE ANN. § 48.051 (West 2019).
report is in the alleged victim’s best interest is immunized from professional disciplinary action notwithstanding whether the information is otherwise considered confidential.205 The professional conduct rules of the state of Georgia allow a lawyer to reveal what would otherwise be confidential information if the lawyer reasonably believes that the revelation is necessary to avoid or prevent substantial financial loss that would result from third-party criminal conduct.206

On the other end of the spectrum, the Model Rules of Professional Conduct are vague as to what approach should we lawyers take if our client is not the vulnerable beneficiary but is the fiduciary — the trustee or guardian or agent under a power of attorney — who is entrusted with the care of an individual’s welfare or property. Some of those states that have addressed the issue of an attorney’s duties in these circumstances have taken the position that the only client of a lawyer who represents a fiduciary is the fiduciary.207 Under this theory, the fiduciary’s lawyer owes few duties, if any, to the “beneficiaries” of the relationship — that is, to the principal in a power of attorney relationship if an agent is the client or to the protected individual if the client is the guardian. While this theory offers some comfort for the lawyer in that it is clear to whom his or her loyalty is owed, it offers scant protection for individuals who are not in a position to protect themselves. I propose that instead of supporting this simplistic view of the client-lawyer relationship, we lawyers should promote a theory that gives us the leeway and discretion to take action to protect those who cannot protect themselves when we see that the actions of the fiduciary-client are endangering the welfare of another individual.208

206 GA. CODE ANN. § 4-102-1.6(b)(1)(i) (2020).
207 See, e.g., N.H. REV. STAT. ANN. §§ 564-B:2-205(c), 556:31(I)-(II) (2020) (attorney-client privilege in a trust or wills context applies to communications between the fiduciary and the lawyer for the fiduciary); see also OHIO REV. CODE ANN. § 5815.16 (LexisNexis 2020); see also S.C. CODE ANN. § 62-1-109 (2020).
208 Section 51 of the Restatement (Third) of the Law Governing Lawyers makes a start in this direction. Section 51(4) provides that a lawyer owes a duty of care to a nonclient to the extent: (a) the lawyer’s client is a trustee, guardian, executor, or fiduciary acting primarily to perform similar functions for the nonclient; (b) the lawyer knows that appropriate action by the lawyer is necessary with respect to a matter within the scope of the representation to prevent or rectify the breach of a fiduciary duty owed by the client to the nonclient, where (i) the breach is a crime or fraud or (ii) the lawyer has assisted or is assisting the breach; (c) the nonclient is not reasonably able to protect its rights; and (d) such a duty would not significantly impair the performance of the lawyer’s obligations to the client. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(4) (AM. LAW INST. 2000).
4. Asking for Trusted Contact for Client

We as lawyers should follow the lead of other allied professionals about steps to take in advance of abuse occurring. For example, in 2017, regulations issued by the SEC encourage brokers to procure from all clients the name of a “trusted contact” who can be contacted in the event that the broker suspects that financial exploitation is occurring.\textsuperscript{209} The ACTEC Commentary to Model Rule 1.14 suggests a similar approach by lawyers, stating that “A lawyer may properly suggest that a competent client consider executing a letter or other document that would authorize the lawyer to communicate with designated parties . . . concerns that the lawyer might have regarding the client’s capacity.”\textsuperscript{210}

D. What Can All Individuals Do?

Question #3: What can we (everyone in this room) do on an individual basis to help curb elder financial abuse while at the same time guarding against over-protection of our elderly citizens?

1. Education about Elder Financial Abuse

First, we must all recognize elder financial abuse for the national epidemic that it is. Mickey Rooney’s testimony before Congress in 2011 (facilitated by ACTEC Fellows Bruce Ross and Vivian Thoreen)\textsuperscript{211} helped bring this issue to the forefront but it still travels largely under the radar screen. In addition, the abusers are becoming more and more sophisticated so that those of us who are still in a position to warn others must make efforts to educate ourselves daily about the latest scams. For example, scammers have learned how to manipulate Caller ID so that the name of a bank or charity will pop up when the scammer makes a call.\textsuperscript{212} “Free-trial offers” of anti-aging products have locked many unsuspecting individuals into long-term, costly, fine-print “subscriptions”


\textsuperscript{211} Mickey Rooney’s emotional testimony on elder abuse, \textsc{Youtube} (Mar. 3, 2011), https://www.youtube.com/watch?v=W9iK5P5-s5A.

\textsuperscript{212} Clark Howard, What is caller ID spoofing and how do I protect myself from it?, \textsc{Clark Howard Inc.} (Dec. 4, 2018), https://clark.com/scams-rip-offs/safeguard-yourself-against-caller-id-spoofing/.
that are very difficult to cancel. As I mentioned before, internet fraudsters have learned to offer free “security scans” of computers that often result in money being stolen or private information being compromised. Scammers are bombarding us by email also. In fact, even as I was in the process of writing up this lecture, I received a not-so-official-looking email from Western Union informing me that I was one of seven lucky email beneficiaries who had been chosen to receive $1,500,000 in the United Nations Humanitarian Aid/Poverty Alleviation. I was cautioned, however, that the Western Union “transfer policy” only allowed them to pay me in daily increments of $7,600. (Suffice it to say, I did not respond.)

We all know vulnerable adults with whom we could have a conversation about warning signs of potential abuse. Once we recognize the myriad of scams that are out there, we can make simple but effective suggestions to our older loved ones — suggestions like “Never give out personal information over the phone no matter what name shows up on the Caller ID;” “Never allow anyone access to your computer;” “Install malware or spyware filters for computer protection;” or something so simple as “Just hang up!”

We also can familiarize ourselves with the range of services available to an older individual who is experiencing difficulties in managing her own affairs. It is possible today, for a relatively modest fee, to have a professional service (rather than your drug-addicted son) handle your bill paying or to use a ride-sharing service to get you to your medical appointments (rather than depending upon that same son). Companies now offer prepaid credit/debit cards that can be set up to disable certain types of transfers and limit ATM withdrawals yet still offer financial independence to the card holder. Modern technology, for all its faults, provides wonderful opportunities for many to remain in their homes for much longer periods than were formerly possible. But remaining in one’s home also may contribute to social isolation, so another way in

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217 There are services today that will shop for and deliver groceries or even deliver already-cooked meals thus reducing an older individual’s dependence upon caregivers. See Christine Yu, 13 Healthy Meal Delivery Services Across the Country That Are a Must
which we here today can help our vulnerable loved ones is simply to keep in touch.

2. Avoid Over-Protection

But what about the other lurking danger that we must combat at the same time that we are fighting the skyrocketing onslaught of elder abuse? That danger, as I have mentioned numerous times, is the danger of over-protection — of suffocating an older person’s autonomy by our well-meaning attempts to protect her. One way to begin to address this danger is to confront the inclination we all have to stereotype older individuals and treat them as if they were a homogenous group. Although the statistics about the increased vulnerability that sometimes accompanies advancing age are depressing (for example, as mentioned earlier, one in ten people age 65 and over has Alzheimer’s Disease), it is vital to remember that every statistic has two sides. In other words, nine in ten people of that age are not suffering from the disease. While 48% of women age 75 and older are living alone (that is, without anyone to help them with their daily life activities), the other half of older women live within support networks of some sort. Trends from the 1990s to the present show that the percentage of older women age 85 or older who are living in nursing homes has actually dropped, from 27% in 1990 to 13% in 2014. And yes, because our children are more and more likely to be “boomerang children,” (children who as adults have returned to live with their parents), this has led to an increasingly larger percentage of older individuals living not alone but in multi-generational households. This is all by way of saying that we cannot deal effectively with elder financial abuse problems unless we recognize and honor the diverse nature of the population with whom we are dealing. Many of the individuals sitting in this room today personify the theory that older Americans are vibrant, in-touch, engaged, and actively participating in life rather than sadly mourning its passing.

3. Combat Stereotypes and Generalizations

We are the ones who must work to eliminate the profound negative effect of ageist stereotyping. How do we do this? We can begin with the simple process of vowing to excise certain words from our vocabulary, like “shriveled up,” “dotty,” “old maid,” “old hag,” “blue haired,” “little

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218 Ari Houser, Women & Long-Term Care, AARP PUB. POLICY INST. (2007), https://assets.aarp.org/rgcenter/il/fs77r_ltc.pdf.
219 Stepler, supra note 27, § 2.
220 Id.
old lady,” “old codger,” and “over the hill.” I was tempted to put the term “old coot” on this list but then I read this definition on the AARP website: “A coot is a tough, adaptable water bird. [It] can fly and swim. Can you?”

Why should we attempt to eliminate these stereotyping terms and images? Many psychological studies illustrate that stereotyping has lasting negative effects on those who are the victims of it. For example, a Canadian study in 2018 intentionally placed individuals in situations in which they faced prejudice based on a variety of factors such as age, race, religion, or gender. The study found that these subjects not only experienced an immediate negative reaction but they also later were more likely to be more aggressive, exhibit a lack of self-control, “have trouble making good rational decisions, and over-indulge in unhealthy foods.” And the same pattern emerged, regardless of whether the prejudice was based on their gender or race or any other factor.

On the other end of the spectrum, in a 2014 study, participants age 60 and older were exposed to subliminal positive age stereotypes for four weekly sessions. Compared to the control group, these individuals showed decreased levels of internalized negative age stereotyping and strengthened positive self-perceptions of aging. Even more impressive is that those exposed to the positive age stereotypes showed improvement in their physical function that surpassed the improvement of others of similar age who had engaged in a six-month exercise program. Recent studies are showing that positive self-perceptions about growing older are correlated with quicker recovery from severe disability, shorter hospital stays, and even increased longevity.
Hand-in-hand with the negative stereotypes about old age come the negative generalizations about old age that people in our society — including both the scammers and those who are trying to defeat them — use as a basis for their decision-making. While many generalizations are based soundly in fact, they also tend to be the refuge of those who do not want to take the time to examine where the whole truth lies. Before wrapping up, let’s look quickly at three common generalizations about aging and then at some of the studies that should give us pause before accepting these generalizations as truth.

**Generalization #1: Older people, particularly old women, are depressed and unhappy.**

This generalization may explain why so many scammers target older women with products that purport to reverse aging or with relationships that promise to bring back the joyfulness of their youth. Researchers are only beginning to delve into whether this generalization is an accurate one. It has been discovered that overall happiness does indeed drop as one enters middle age, but it rises again beginning about age 60. A 2017 British study proclaimed that women are generally unhappier than men until the women reach about age 85. At that point, women’s happiness levels begin to outstrip those of men. Why is this? Psychiatrists were asked to ponder a reason for this finding and several posited that this is because so many women are widowed at that point in their lives and are beginning to enjoy retirement.

**Generalization #2: Older people, especially older women, lack the ability to make sound decisions.**

Studies conducted as recently as 2009 led us to believe that this generalization was true. In fact, I mentioned one of these studies earlier when I spoke about financial capacity. But in 2013, a MetLife study mentally, physically, and psychologically younger. See Christopher Bergland, *Positive Attitudes About Aging May Be a “Fountain of Youth”*, PSYCHOL. TODAY (Jan. 30, 2016), https://www.psychologytoday.com/us/blog/the-athletes-way/201601/positive-attitudes-about-aging-may-be-fountain-youth.


231 Id.

232 Id.

called “Healthy Brain, Healthy Decisions” added a bit more nuance to this generalization. The MetLife study revealed that earlier studies had focused on the older population as a whole, including among the test group individuals who were suffering from dementia. The MetLife study found that healthy older individuals did not show an age-related decline in decision-making ability. Rather, the study found that both strategic learning capacity and the conscientiousness of one’s decisions in fact increased with age. A Harvard Medical School Report provides this description of the effect of physical age-related changes in the brain:

> These [physical] changes enable the aging brain to become better at detecting relationships between diverse sources of information, capturing the big picture, and understanding the global implications of specific issues. Perhaps this is the foundation of wisdom. It is as if, with age, your brain becomes better at seeing the entire forest and worse at seeing the leaves.

The poet Robert Frost expressed the same concept, perhaps more eloquently when he said:

> I think young people have insight. They have a flash here and a flash there. It is like stars coming out in the sky in the early evening. . . . [However,] it is later in the dark of life that you see forms, constellations.

As to the brains of women in particular, a study published in February 2019 in the Proceedings of the National Academy of Science showed that, while many people’s brains tend to “shrink” with age, on average, the physical make-up of female brains is about three years younger than that of male brains and that “[o]lder women tend to score better than men of the same age on tests of reason, memory and problem solving.”


235 Id.


239 Id.
Generalization #3: Older people are less creative and less able to learn than younger people. (AKA: You can’t teach an old dog new tricks.)

A persistent generalization in our society is that youth and creativity and mental flexibility are reciprocally related. The corollary to this generalization is that older individuals are “stuck in ruts” and unable to generate new ideas and thus lack the creativity and vision that is the lifeblood of our commercial culture. Why is this generalization dangerous and why is it relevant to today’s discussion? It is dangerous because, like so many stereotypes and generalizations, it has both internal and external consequences. Older people who internalize this concept may refrain from engaging in the types of novel post-retirement activities that have been found to contribute to enhanced physical and mental health and improved social interaction and independence. Their excuse will be that they are just “too old” to try or learn anything new. When they are isolated and in poor health, their dependence on others (including potential abusers) as well as their susceptibility to scammers is heightened.

In terms of external consequences, the connection is a bit more complex. Among other things, this generalization encourages influential industries, such as the advertising industry, to pass over older job applicants and opt instead to hire “dynamic” or “new-wave” or “progressive” (aka “younger”) workers. In ad agencies, for example, more than 60% of the employees are age 25-44 and only 5% are over age 50. In fact, the advertising industry has been referred to as a “Peter Pan industry” where age discrimination is “on steroids.” These younger “hip” workers then proceed to saturate the media with images that perpetuate the “youth = beauty” myth and its corollary (“old age is

240 “One of the most widespread and persistent myths about creativity is that it is the domain of the young. So for example in surveying popular attitudes toward aging, the psychologist Dean Simonton observed that ‘Most conspicuous is the notion that creativity is the prerogative of youth, that aging is synonymous with a decrement in the capacity for generating and accepting innovations.’” David Galenson, Old Age and Creativity in Art and Science, HUFFINGTON POST (Dec. 6, 2017, 3:34 PM), https://www.huffingtonpost.com/david-galenson/old-age-and-creativity-in_b_2272877.html.

241 The AARP lists the following words as being used by employers to mask ageism in their job advertisements: “recent college graduate,” “digital native,” “cultural fit,” “energetic person sought for young company,” “five to seven years experience.” Ann Brennoff, 5 Ageist Phrases to Be Aware Of, AARP (June 12, 2019), https://www.aarp.org/disrupt-aging/stories/info-2019/ageist-phrases.html.


not pretty”). This saturation gives fraudsters a powerful psychological tool for hocking their most notorious scam products — the so-called “anti-aging” products. These include counterfeit cosmetics, soaps, lotions, pills and other “nutritional supplements,” and a myriad of “scientific breakthroughs” that can make you “look 10 years younger in just 30 days.” The FBI reports that these fraudulent products “may contain arsenic, beryllium, and cadmium — all known carcinogens — along with high levels of aluminum and dangerous levels of bacteria from sources such as urine.”

To comprehend the danger here, we need only look at the outbreak of fake Botox injections in the last decade that left the victims with burns and swelling and, in some cases, even poisoned with botulism.

In short, these youth-culture industries feed widespread stereotypes about the elderly, including that they are ugly, frail, feeble, and even laughable.

Everyone remembers some version of this ad: “I’ve fallen and I can’t get up.” Why not replace that image with ads that celebrate the vitality and beauty of age, such as the ad from the British department stores Harvey Nichols? The Harvey Nichols ad commemorates the 100th year anniversary of the fashion magazine Vogue and the model in the magenta-colored cape, Bo Gilbert, is 100 years old.

So, does science support the theory that creativity and elasticity in the brain degenerate with age? Not necessarily. First of all, there are notable exceptions to the theory that age hampers creativity:

- Benjamin Franklin invented the bifocal lens at the age of 78.

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247 The Life Alert ad shows a frail older woman on the floor in her home. Life Alert, lifedirect.com (last visited May 5, 2020).


249 Michael Benton, Benjamin Franklin Bifocals, Benjamin Franklin (Nov 6, 2013), http://benjaminfranklinbio.com/bifocals-benjamin-franklin/122/.
Frank Lloyd Wright, who died at age 91, spent the last 15 years of his life involved in the design and construction of the Guggenheim Museum in New York.250

Giuseppe Verdi wrote the opera Falstaff when he was nearly 80 years old.251

Anna Mary Robertson Moses (better known as “Grandma Moses”) took up painting when in her late 70s and, by the time of her death at age 101, completed over 1500 paintings.252

Perhaps more interesting is the fact that recent studies are showing that the aging brain bears many similarities to the so-called “creative brain.”253 In her poem “Warning,” Jenny Joseph bemoans the constraints and strictures of her current life of sober middle age.254

She longs for the day when she can:

. . . go out in my slippers in the rain
And pick flowers in other people’s gardens
And learn to spit.

It is exactly this type of fearlessness and lack of inhibition that is now revealed to be an essential component of creativity. Aging brains exhibit a “thinning” of that portion of the prefrontal cortex that governs self-conscious awareness.255 Some scientists believe that this results in less of a need to please other people. And this trait is one that is also prevalent among highly-creative individuals.256

In addition, older individuals tend to be more distractible than younger individuals.257 That makes us sound as if we are in fact “dotty,” but this inability to ignore extraneous or irrelevant information, which is

254 In “Warning,” Jenny Joseph says,

But now we must have clothes that keep us dry
And pay our rent and not swear in the street
And set a good example for the children.
We must have friends to dinner and read the papers.
Joseph, supra note 1.
255 Carson, supra note 253.
256 Id.
257 Id.
called “cognitive disinhibition,” aids the creative spirit. The opposite of “cognitive disinhibition” — what is sometimes referred to as “cognitive control” — is “the ability to limit attention to goal-related information.” While cognitive control certainly aids all of us in performing a wide range of daily tasks, neuroscientists are now positing that reduced cognitive control can enhance one’s ability to detect patterns and “to approach tasks or problems in a novel manner and reach solutions by relying on broad associations formed between diverse bits of information from a wide variety of sources.” Thus, as one researcher has concluded, “the evidence suggests that reduced cognitive control in older adults may boost creativity and their ability to solve insight problems.”

V. Conclusion

I realize that my remarks today have bounced between two parallel and perhaps colliding universes: that of the sad older woman in a “red” world who is in cognitive decline, is vulnerable, and is in need of protection from both strangers and loved ones who may take advantage of her weakness and susceptibility and that of the vibrant, happy older woman in a “purple” world who lives powerfully and steadfastly pursues her dreams and her potential. And sometimes just likes to gamble. I hope that, among other things, my remarks today will help all of us to envision life in parameters other than chronological age. Remember, young people have fantasies too. Would we institutionalize or impose a guardianship upon a 25-year-old man who spent all of his time indulging his fantasy, to the point that he missed school and didn’t show up for work? Would we take away from him the legal authority to spend his money as he pleased and decide that he needed to have someone else appointed to make decisions for him about the management of his property? Probably not.

In conclusion, we definitely need to face head-on the reality of elder financial abuse but we need to frame the threat as one to those who are vulnerable and susceptible and of diminished capacity rather than to those who have merely reached a certain chronological age. We

258 Margarita Tartakovsky, The Link Between Creativity and Eccentricity, PsychCentral (July 8, 2018), https://psychcentral.com/blog/the-link-between-creativity-and-eccentricity/.


260 Id. at 909.

261 Id.
need to protect the many older “alone” vulnerable women in our society but part of that protection must include a vigilant awareness that aging provides for many women not a descent into “madness” but rather a loosening of the restraints and filters that permeated their lives when young. The fact that these filters have worn down does not automatically mean that these women have “lost it” and are in need of someone to make more rational, “appropriate” decisions for them.

In short, sometimes older women simply want to spend their pensions on brandy (lots of it) and eat sausages by the pound rather than seven servings of fruits and vegetables a day; they want to wear terrible shirts and grow fat rather than dressing in an age-appropriate manner and counting their calories; and sometimes we older women simply want to wear purple with a red hat that doesn’t match.
Commentary and Dialogue
Married Is as Married Does(?)

William P. LaPiana*

It is better to marry than to burn.¹

Whatever today’s understanding of the verse from the First Epistle to the Corinthians, it clearly coveys the idea that marriage is the way to cabin and control sexual desire, and, by extension, is the foundation of the idea of family since human reproduction therefore will take place between persons married to each other.

So much for theory, theological or otherwise. But it would be foolish to dismiss the role of children in the development of the legal shape of the institution of marriage. This brief comment to Prof. O’Brien’s article argues that whatever the future of non-ceremonial marriage—and Prof. O’Brien makes a strong case for its reanimation in the law of the United States—the future of marriage is ineluctably linked to the development and acceptance of assisted reproductive technology (ART), the use of which in turn is creating new model families strongly influenced by the ascent of individuality and heightened liberty the article describes.

As Prof. O’Brien notes, children play an important part in the legal development of marriage, and he describes the institution beginning with couples sharing a mutual commitment “usually predicated upon survival, care of children, and perhaps emotional attachment.”² Even the extension of the right to marry to same-sex couples in Obergefell v. Hodges³ rests at least in part on the belief that “[m]arriage confers material protection for children and families,”⁴ a statement that leads one to wonder exactly what is the relationship between a couple, their raising children, and being a family. For some that relationship is a strong one. Both the American Law Institute’s Principles of the Law of Family Dissolution, and Prof. Lawrence Waggoner’s proposed Uniform De

⁴ Id. at 2600.

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Facto Marriage Act, discussed in the article, create a presumption that two persons are domestic partners where, among other criteria, the couple’s “common child” is part of the couple’s household. Under the ALI scheme, a couple maintaining a common household “are” domestic partners if their common child resides in the household for the period of time specified in state law; unmarried couples without common children also can be domestic partners, but even if they maintain a common household for the period of time specified by local law, they are only “presumed” to be domestic partners, a presumption that can be rebutted.

Another example of the close link between marriage and parentage is directly related to the legalization of same-sex marriage. One of the oldest and most basic presumptions of family law is that a child born to a married woman is the child of her husband. That presumption has been extended to two married women, one of whom gives birth through ART. While this result is usually a matter of constitutional law, whether federal or state, the result is that parentage is determined by the status of being married, whether or not the spouse could be the other genetic parent of the child. As these cases show, the association between marriage and parentage is altered by the separation of genetics from parenthood made possible by ART.

In vitro fertilization (IVF) makes possible the separation of fertilization from coitus and the resulting embryo can be implanted in the uterus of a woman who is not the creator of the ovum and who is usually described as a gestational surrogate. A married couple who for whatever reason do not conceive a child through sexual intercourse can in many United States jurisdictions receive donations of ova and sperm, arrange for IVF of the ova with the sperm, and then contract with a gestational surrogate. There are five people involved in this arrangement, but where surrogacy contracts are legally enforceable, the married couple who

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6 Id. § 6.03(3). Under section 6.03(5) parentage of the child can be legal parentage or parentage by estoppel.
7 This presumption is the basis of statutory rules making the husband of a woman who conceives through artificial insemination using the sperm of a man other than her spouse and then gives birth the father of the child. See, e.g., Tex. Fam. Code Ann. §§ 160.703, 160.704 (West 2019) (all children of assisted reproduction).
8 Pavan v. Smith, 137 S. Ct. 2075 (2017); Henderson v. Box, 947 F.3d 482 (7th Cir. 2017).
10 For a decision resting on state family law and general principles of equitable estoppel where the sperm donor was known to the spouses, see Christopher YY v. Jessica ZZ, 69 N.Y.S.3d 887 (N.Y. App. Div. 2018) and Joseph O. v Danielle B., 71 N.Y.S.3d 549 (N.Y. App. Div. 2018).
made all the arrangements are the parents of the child and the donors of the gametes and the gestational surrogate are not parents. An unmarried person could also become a parent through surrogacy to the exclusion of the gamete donor or donors and the surrogate.

Not every surrogacy arrangement proceeds according to a contract, or at least one that is legally recognizable. In those situations, there may be more than two persons who wish to have a parent-child relationship with the child where all of the persons involved not only know each other but remain in contact after the child’s birth. In David S. v. Samantha G., a married male couple, David S. and Raymond T., and a female friend, Samantha G., decided to have a child together. The men delivered sperm to the woman on alternate days, and she did become pregnant through artificial insemination without medical supervision. Testing showed Mr. S. to be the genetic father of the child, and he signed an acknowledgment of paternity when the child was five days old. The three adults sought clarification of their parental rights. The New York Family Court held that Mr. T. has standing to seek custody and visitation even though the child has two legal parents. This decision is consistent with another New York case in which the court issued a “tri-custody order” giving joint custody to the biological father, his former wife, and another woman who is the biological mother and the partner of the father’s ex-spouse, even though the child already had two legal parents.

These New York cases deal only with custody, visitation, and the support obligation and do not create a parent-child relationship between the third parent and the child for all purposes—the child is not an heir in intestacy of the third person who has parental rights and obligations and vice versa, although the child might have a claim to be an heir under some version of the theory of equitable adoption, which varies greatly from jurisdiction to jurisdiction. Under the Uniform Parentage Act (2017), however, de facto parentage can be established through clear

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14 Id. at 731.

15 Id.

16 Id.

17 Id. at 734.


19 Compare O’Neal v. Wilkes, 439 S.E.2d 490, 492 (Ga. 1994) (needing to prove binding promise between alleged parent and a person who had legal authority to offer the child for adoption), with In re Estate of Ford, 82 P.3d 747, 755 (Cal. 2004) (requiring clear and convincing evidence of an intention to adopt or of the decedent’s statements that the child was an adopted or a genetic child), and In re Estate of North Ford, 200
and convincing evidence of seven factors all related to acting as a parent.\textsuperscript{20} Once de facto parentage is established, the parent-child relationship exists for all purposes, presumably including inheritance and inclusion in class gifts in donative documents.\textsuperscript{21} The Act also includes an optional provision that allows a court to find that a person has more than two parents.\textsuperscript{22} Not surprisingly, the Act says nothing about the legal relationship between or among the parents, nor is the subject addressed by the two states that have statutes recognizing de facto parentage\textsuperscript{23} nor by the court opinions that recognize de facto parentage under section 204(a)(5) of the 1973 Uniform Parentage Act, providing a man is presumed to be the father of a child if during the first two years of the child’s life the man resided in the same household with the child and “held out the child as his own.”\textsuperscript{24}

Assume a situation like that in \textit{David S.}: the third parent is married to a biological parent and the other biological parent has no legal relationship to the married couple except as a parent of the child. On the death of the other biological parent, the child is an heir and can be the beneficiary of a will or of non-probate property, but the child’s only right under a will is standing to challenge it (assuming the applicable omitted child statute does not apply) and in any event some or all of the decedent’s assets may be outside of the probate estate. A will that does benefit the child or the other parents is open to challenge by the other heirs of the decedent and those heirs might be more inclined to challenge a will that benefits the married couple. It seems to be all but impossible to prove undue influence by one spouse on another, but the decedent is not a spouse.

If the third parent is not married to another parent, the child has even less legal protection. We assume that the economic interests of minor children at least will be protected by whatever legal device prevents disinheriance of a surviving spouse and that non-marital children are often the subject of some sort of agreement to support during life and perhaps to make a gift at death. The structure of the Uniform Probate

\textsuperscript{20} \textit{Unif. Parentage Act} § 609(d) (Unif. Law Comm’n 2017).
\textsuperscript{21} \textit{Id.} § 203.
\textsuperscript{22} \textit{Id.} § 613 alternative B.
Code’s intestacy provisions for surviving spouses is based at least in part on the idea that decedents “see the surviving spouses as occupying somewhat of a dual role, not only as their primary beneficiaries, but also as conduits through which to benefit their children.”25 Without the status of surviving spouse, however, there is no conduit in intestacy nor is there likely to be any way for the family to have access to the property of the deceased parent, especially if the child is not an heir of the decedent.

Now add the fact that all the adults maintained a common household in which the child was raised, a prerequisite for finding a domestic partnership under the ALI Principles and for finding de facto parentage under the Uniform Parentage Act section 609(d)(1). The basic argument Prof. O’Brien makes—“the state structure of marriage should not thwart the fundamental right of individuals to form families in the manner that privacy and liberty sustains . . .”26—applies to these families of more than two adult partners, especially where the relationship among them is founded on their parentage of a child or children living with them, whether parentage comes from biology, adoption, or de facto parentage (whether or not extending to property rights at death). As we have seen, the combination of medical technology and growing ideas of individuality and liberty makes it more likely that more than two persons can plausibly claim the role of parent in a person’s life.

The legal and policy mechanism for tipping the balance in favor of changing legal rules related to the family often is the concept of “the best interest of the child.”27 Where the child’s emotional and financial security can be enhanced by creating a legal relationship among all those who are in some way legal parents of the child, courts and legislatures may be inclined to find a way to do so, just as the courts seem more and more inclined to find that a child can have more than two parents for purposes of custody, visitation, and support. And once the multiple parent household is seen as a unit, economic partnership arguments for existence of rights in the property of a deceased partner, whether through community property or the elective share, become easier to make to courts and legislatures.

Another way to put it is that the cases and statutes dealing with the parentage of a child born to a married couple show marriage driving parentage no matter what the biological relationship between parents

26 O’Brien, supra note 2, at 100.
27 See, e.g., In re Jacob, 660 N.E.2d 397, 399, 402 (1995) (best interest of the child an important component of decision allowing second parent adoption under existing statutes).
and child. Perhaps we are on the verge of parentage, no matter how created, driving marriage. The future of non-ceremonial marriage may be even more significant than Prof. O’Brien hopes.
Marriage: The Surest Way to Entitlements

L. Victoria Meier*

In Raymond O’Brien’s article “Marital Versus Nonmarital Entitlements,” Mr. O’Brien suggests providing the ever-growing number of cohabitating couples marital-type entitlements based on their relationship.1 It is my opinion that marriage consummated pursuant to the state’s statutory provisions is the best indicator of who should be entitled to benefits as a result of their union. The main reason to maintain statutory marriage as the measure for entitlements is that statutory marriage provides clear and convincing evidence of the couple’s intent to be married. It also allows efficient and timely distribution of entitlements resulting from death or disability of a spouse because the delay caused by the need to prove in a court of law that a common law marriage existed is avoided. Moreover, the requirements of a ceremonial marriage are straightforward, available to everyone and easy to accomplish. Lastly, alternative methods are available to protect cohabitating couples, such as providing for the other through beneficiary designations, estate planning documents and written agreements.

The most obvious reason to dissuade couples from relying on common law marriage for marital type entitlements is that each state has existing laws that permit its adult citizens to get married.2 These laws are generally uncomplicated, requiring only that the couple complete a marriage license, pay a nominal fee and have their union solemnized by an appropriate party. Couples can be married within a week of applying for the marriage license3 and in some states within one day.4 If the couple’s intent is to be married and to provide for each other, the existing state marriage laws provide a direct, efficient route to marriage with little cost or effort.

Unlike a ceremonial marriage, common law marriage has been abolished in all but a few states.5 The main reason common law mar-

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* Partner, Eberle Berlin.
3 Id.
4 See id.
riage has gone by the wayside is that there is no longer a need for it now that couples can get married formally.\textsuperscript{6} Other reasons for abolishing common law marriage provided by various states are that abolishment prevents fraudulent common law marriage claims\textsuperscript{7} and prevents an undue burden on the courts and administrative agencies distributing benefits.\textsuperscript{8}

With common law marriage, the party seeking entitlements has the burden of proving that the couple was all “but” married.\textsuperscript{9} While the requirements to prove common law marriage are few, namely proof of the couple’s mental capacity to marry, the couple’s present intent to be married, the couple holding themselves out as married, and the couple’s agreement to be married, these elements are difficult to prove in court.\textsuperscript{10} One issue is that the putative spouse has to prove by clear and convincing evidence if the other spouse is deceased that the couple had the intent to be married now versus in the future.\textsuperscript{11} If both parties have the intent to be married and are available to testify to their intent to be married, why not have a ceremonial marriage? But often the putative spouse has to rely on historical evidence and witness testimony that may be unavailable because of the passing of time or the death and/or the murky memory of witnesses.\textsuperscript{12} The reliance on historical facts and the memories of witnesses give family members of the deceased the ability to remember the facts in a manner most beneficial to them, creating family conflicts, most of which could be remedied by obtaining a ceremonial marriage. Not only is it difficult to produce evidence of common law marriage, the cost to put on the evidence and witness testimony has the effect of reducing the entitlement value the putative spouse is trying to obtain. These issues can be avoided by marriage under state law.

State law marriage allows for the expeditious administration and distribution of a deceased spouse’s estate. Unlike an estate of a couple relying on common law marriage, the administration of an estate of a deceased spouse who was married under state law is not delayed by a court hearing to determine if the partner has the status of spouse.\textsuperscript{13}

\textsuperscript{7} Id. at 160. See Staudenmayer v. Staudenmayer, 714 A.2d 1016, 1019 (Pa. 1998).
\textsuperscript{9} Staudenmayer, 714 A.2d at 1020.
\textsuperscript{12} Id. at *13.
\textsuperscript{13} \textit{In re} Estate of Hammonds, 315 N.E.2d 843, 845 (Ohio Ct. Com. Pl. 1973).
Therefore, soon after the death of one spouse, the surviving spouse can be appointed the executor or administrator of the deceased spouse’s estate under the statutory provisions of the probate law and thereafter receive all or a portion of the decedent’s estate, depending on the characteristic of the property as either community or separate property.\textsuperscript{14}

It is true cohabitation of couples is on the rise.\textsuperscript{15} The reasons for cohabitating instead of marrying vary. Some couples cohabitate because they do not believe they have sufficient economic resources to marry, such as money to provide for the wedding, etc.\textsuperscript{16} In my opinion these couples are the most deserving of entitlements based on marriage because they have the intent to be married.

The next category is those couples testing out their relationship.\textsuperscript{17} In my opinion these couples do not have the required intent to marry and therefore should not receive entitlements based on their union. Then there are those couples making a conscious decision to cohabitate to avoid financial entanglements and to receive benefits they would not otherwise receive.\textsuperscript{18}

\textit{[T]he incentives built into the current laws regulating marriage and cohabitation do not uniformly favor the marriage option. For example, a widowed individual who receives federal Social Security benefits as the survivor of his or her deceased spouse will automatically lose the benefits upon remarriage, but not upon the formation of a cohabiting relationship. In a similar manner, some state alimony laws provide for the automatic termination of alimony upon the recipient’s remarriage, but not upon a post-divorce cohabitation.}\textsuperscript{19}

Should a partner who chooses to cohabitate instead of marrying be entitled to receive benefits as a single individual and then when it suits them allege they were common law married and receive benefits? This is equivalent to having your cake and eating it too.

Marriage provides certain benefits such as survivor benefits under Social Security, inheritances and the like which are not available to single individuals. However, couples who elect not to get married or who delay marriage can protect and provide for each other using beneficiary

\begin{footnotes}
\item[14] Id.
\item[16] Id. at 92.
\item[17] Id.
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designation on their retirement accounts, life insurance and other beneficiary designation accounts. These couples can also make provisions for each other under their wills and trusts. Annuity or retirement accounts can be used to provide lifetime income to the partner, and cohabitation agreements can provide for property divisions.

While not perfect there are means for cohabitating couples to provide for each other. If the couple finds those means unacceptable then such couples should solidify their relationship with a ceremonial marriage. Why return to a law that was abolished by the majority of states in order to provide benefits to couples at the most difficult time of their relationship? Ceremonial marriage produces a record of the couple’s intent that can be relied upon for the efficient sorting out of family lines, determination of who is eligible for benefits, and clarification of property rights upon termination of the relationship.  

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The Elimination of Section 2035 in Relation to
*Powell* and *Cahill*

Ronald P. Wargo*

The recent Article *Gifts in Contemplation of Death: Why Can’t Section 2035 Simply Die?* by Professor Stephanie J. Willbanks provides an excellent argument for eliminating Internal Revenue Code (“IRC”) section 2035.1 In this commenter’s experience, IRC section 2035 does not arise in day-to-day practice. The section most often applies to transfers of client-owned life insurance policies to irrevocable trusts. However, practitioners should also be aware that the relatively recent *Powell*2 and *Cahill*3 cases bring IRC section 2035 squarely into the purview of practitioners wishing to address possible inclusion of family limited partnership interests and other assets which decedent believes were transferred during life. Specifically, repairing transactions that may be included in a decedent’s estate under IRC section 2036 will invoke section 2035 if the client dies within three years of the repair attempt.

I. **Estate of Powell**

The *Powell* case included all family limited partnership assets in a decedent’s estate using IRC section 2036(a)(2) even though the decedent only owned limited partnership interests at death.4 In that case, the decedent contributed $10 million of cash and marketable securities to a limited partnership.5 The decedent received a 99% limited partnership interest and her two children paid for a 1% general partnership interest with unsecured notes.6 The same day, the decedent transferred her 99% limited partnership interest to a charitable lead annuity trust which ultimately benefitted the decedent’s two children.7 All of these transfers were accomplished by one of the decedent’s two children acting under a

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* Partner, Friedemann Goldberg Wargo Hess LLP.
5 Id. at 394.
6 Id. at 394, 422.
7 Id. at 395.
power of attorney,\textsuperscript{8} and the decedent died within 7 days of the transfer.\textsuperscript{9} This deathbed planning triggered IRS review and likely helped the court reach its result.

The IRS argued that all of the assets of the limited partnership (not just the limited partnership interests) were includible in decedent’s estate under IRC sections 2036(a)(1), 2036(a)(2), 2038, or under IRC section 2035(a) if the transfer to the charitable lead annuity trust was deemed valid.\textsuperscript{10} The taxpayer argued that since the decedent did not own any limited partnership interest at death, then sections 2036 and 2038 could not apply.

The Tax Court held that section 2036(a)(2) applied because the decedent, in conjunction with all of the other partners, could dissolve the partnership.\textsuperscript{11} The court also suggested that section 2036(a)(2) applied because decedent could control the amount and timing of distributions in conjunction with the general partner.\textsuperscript{12} Because of this holding, the Tax Court did not address IRC sections 2036(a)(1) or 2038.\textsuperscript{13}

II. \textit{Powell} and IRC Section 2035

Because the assets were included in the decedent’s estate under IRC section 2036(a)(2) because of the court’s broad holding, there may have been no need to address the IRC section 2035 issue arising because of decedent’s transfer of her entire LP interest to the CLAT.\textsuperscript{14} Nevertheless, the Court found that even if she made a gift of her retained interest prior to death, IRC section 2035 would apply to transfers made within three years of death, such as the transfer to the CLAT.\textsuperscript{15} Such an issue concerns current practitioners given the broad holding in \textit{Powell}. Essentially, practitioners are concerned that because partners can always unanimously agree to terminate a partnership, any of the assets contributed to the limited partnership could be brought into the estate of a decedent under IRC section 2036(a)(2). If a decedent transfers those remaining limited partnership interests through a gift, sale, or charitable contribution, then IRC section 2035 could still possibly bring those assets back into the estate if the decedent dies within three years of the transfer, since those assets would have been included in the dece-

\textsuperscript{8} Id. at 394-95.
\textsuperscript{9} Id. at 394.
\textsuperscript{10} Id. at 396-97, 399.
\textsuperscript{11} Id. at 404.
\textsuperscript{12} Id.
\textsuperscript{13} Id. at 405.
\textsuperscript{14} The court did discuss the applicability of the POA, but such a discussion is beyond the scope of this comment. See id. at 417-19.
\textsuperscript{15} Id. at 404.
dent’s estate under an IRC section 2036(a)(2) Powell analysis.\textsuperscript{16} Therefore, even “fixing” a troublesome partnership does not have certainty for three years.

If Professor Willbanks’ solution of repealing IRC section 2035 were implemented,\textsuperscript{17} then immediately upon transferring the limited partnership interest, those assets would not be included in the decedent’s estate. In fact, such a repeal might have saved the taxpayer in the Powell case, since she did not own the partnership at her death.\textsuperscript{18} The Tax Court specifically noted that taxpayer’s argument that the assets were transferred failed because of the application of IRC section 2035.\textsuperscript{19}

III. ESTATE OF CAHILL

Practitioners’ fears about the broad nature of the Powell holding were increased by Estate of Cahill, a 2018 Tax Court decision that applied Powell’s IRC section 2036(a)(2) analysis to a split dollar life insurance agreement.\textsuperscript{20} In Cahill, the decedent transferred $10 million to an irrevocable trust to purchase life insurance policies on the lives of decedent’s son and his wife.\textsuperscript{21} The decedent expected to be reimbursed when the policies paid, i.e. when the son and wife passed away.\textsuperscript{22} Because those individuals were relatively young, the decedent’s estate valued that reimbursement right at only $183,700.\textsuperscript{23} The IRS countered by saying that the reimbursement should have a value equal to the full cash surrender value of the policies, which was approximately $9.6 million.\textsuperscript{24} The IRS argued that value was includible in decedent’s estate under IRC sections 2036(a)(2), 2038(a)(1), and 2703(a).\textsuperscript{25} The Tax Court denied the taxpayer’s motion for a partial summary judgment.\textsuperscript{26}

The Court cited the Powell opinion, saying that the decedent, in conjunction with the irrevocable trust, could agree to terminate the split dollar agreement, giving the decedent the full cash surrender value.\textsuperscript{27}

\textsuperscript{16} I.R.C. § 2035(a).
\textsuperscript{17} Willbanks, supra note 1, at 174-75.
\textsuperscript{18} Powell, 148 T.C. at 400.
\textsuperscript{19} Id. at 400-01.
\textsuperscript{21} Id. at *4-5.
\textsuperscript{22} Id. at *5-6.
\textsuperscript{23} Id. at *7.
\textsuperscript{24} Id.
\textsuperscript{25} Id. at *10-11.
\textsuperscript{26} Id. at *20. The Tax Court also would have denied the taxpayer’s summary judgment motion with respect to the I.R.C. section 2703(a) issue, but such analysis is beyond the scope of this comment.
\textsuperscript{27} Id. at *14-15.
Such an ability, the Court argued, would bring the cash surrender value in the decedent’s estate under IRC sections 2036(a)(2) and 2038(a)(1). 28

IV. CAHILL AND IRC SECTION 2035

If the decedent had actually transferred his redemption right so he was not part of the split dollar arrangement, presumably IRC section 2035 would have brought the cash surrender value back into the decedent’s estate. In the Cahill case, the decedent died within one year of the split dollar arrangement, 29 so even if he had transferred the cash surrender right, the Tax Court may have argued that it was still in his estate.

In sum, repeal of IRC section 2035 would allow taxpayers and their advisors to fix a transaction that may be brought into their estate under the current expanded reading of IRC section 2036(a)(2). Practitioners could address Powell and Cahill concerns without worrying about their clients’ death within three years.

28 Id.
29 Id. at *3.