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# Tax Court Backs IRS' Rejection Of \$92M Bad-Debt Deduction

By [Natalie Olivo](#)

Law360, Fort Wayne (November 7, 2017, 8:50 PM EST) -- The U.S. Tax Court on Tuesday upheld the IRS' disallowance of \$92 million in bad-debt deductions claimed by a Wisconsin holding company with stakes in paper mill enterprises, finding the debt at issue was not bona fide.

Family-owned VHC Inc. had contended the company owned debt and not equity in a spinoff business operated by a relative, referred to as Ronald H. in the opinion and Ron Van Den Heuvel in VHC's petition, and that the [Internal Revenue Service](#) wrongly disallowed deductions related to the debt, which a series of bad deals had rendered illiquid. However, in sustaining the IRS' disallowance of related deductions for the 2004 through 2013 tax years, Tax Court Judge Kathleen Kerrigan narrowed in on the debt itself, noting that "there is no bad-debt deduction without bona fide debt."

In finding that the debt did not hold up under scrutiny, Judge Kerrigan said VHC began issuing debt in the form of promissory notes to Van Den Heuvel's acquired companies in 1997, notes that purported to reflect advances.

Van Den Heuvel and his companies routinely failed to comply with the terms of the promissory notes and VHC failed to enforce them, Judge Kerrigan said, but VHC continued to advance funds despite an increasing outstanding balance.

"VHC did not intend to create a bona fide debtor-creditor relationship, and the economic circumstances that existed during the time VHC made its advances establish that it did not reasonably expect repayment," Judge Kerrigan said. "VHC is not entitled to related-party bad-debt deductions for the advances it made to Ronald H. and his related companies during the tax years at issue."

In its March 2015 [petition](#), VHC had said that although it declined Van Den Heuvel's solicitations to invest in businesses under his control, the company began issuing debt in the form of promissory notes to his acquired companies for equipment and overhead costs.

Shortly before 2000, VHC issued a line of credit to Van Den Heuvel's cotton fiber plant for the installation of a key machine, thinking the transaction was secured by the fact that United Arab Emirates Investment Ltd. had made an offer on the plant that would have far exceeded the amount of the company's debt. However,

UAEI withdrew from the deal at the last minute after the Sept. 11, 2001, terror attacks, saying the status of a Middle Eastern company in the U.S. had become too risky.

About the same time, Enron, one of the debtor's key backers, filed for bankruptcy.

VHC gave the company even more money after the two collapses to help it get back on its feet, but a series of bad deals would prevent repayment for years, causing VHC to declare the bad-debt deductions on each year's tax returns, according to the petition.

In 2007, however, it appeared that the debt would be repaid with an offer on the mill from [Goldman Sachs](#)-backed ST Paper, to purchase Van Den Heuvel's assets. Believing the deal would bear fruit, VHC waived its bad-debt deduction for its 2006 returns. However, VHC recanted when it learned that under a new arrangement, ST Paper would execute the sale in the form of promissory notes rather than cash payments.

Judge Kerrigan noted on Tuesday that because she concluded the advances did not constitute bona fide debt, she did not need to address whether VHC had shown that the advances became partially worthless.

VHC had argued that if the Tax Court concluded that the advances did not represent bona fide debt, then it was entitled to business expense deductions related to guarantees of the Van Den Heuvel company debts.

However, Judge Kerrigan ruled that the advances were not deductible. She also rejected several other alternative arguments that VHC had put forward, including its contention that it was entitled to deductions because it paid interest from 2009 to 2013 on a bona fide debt.

Counsel for VHC declined to comment, and the IRS does not comment on pending litigation.

VHC is represented by Robert E. Dallman, Daniel B. Geraghty, Robert M. Romashko and Patrick S. Coffey of [Husch Blackwell LLP](#).

The IRS is represented by Christa A. Gruber, Lauren N. May and Danielle R. Dold.

The consolidated cases are VHC Inc. and subsidiaries v. Commissioner of Internal Revenue, docket numbers 4756-15 and 21583-15, in the U.S. Tax Court.

--Additional reporting by Jimmy Hoover. Editing by Aaron Pelc.

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