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IRS Asks To Nix Expert Report In $92M Bad Debt Write-Off Row

By **Jimmy Hoover**

Law360, Washington (July 25, 2016, 2:56 PM EDT) -- The IRS has asked U.S. Tax Court to exclude a “misleading” expert report that a Wisconsin holding company with investments in various paper mill enterprises is seeking to use in a fight over $92 million in disallowed bad debt deductions, arguing the company had unfairly refused to address issues raised in the report when asked by the agency.

In a motion in limine last week, the IRS said that throughout the litigation, VHC Inc. has consistently dodged inquiries into the circumstances surrounding the allegedly illiquid debt only to turn around and submit an expert report on those issues in a “badly disguised attempt to muddy the waters” in the case.

The agency wants to bar a report prepared by Chicago-based accountant Mark G. Kucik concluding that ST Paper LLC and Tak Investments LLC are unable to pay the amounts set out in promissory notes for the acquisition of entities indebted to VHC.

The IRS said that while the report would suggest otherwise, VHC itself had admitted that ST Paper had made payments under the notes.

“To allow petitioners to now file a misleading and irrelevant expert report on ST Paper’s ability to make payments, when petitioners have represented to respondent at various times that payments were made and intentionally withheld any information corroborating such payments is highly prejudicial to respondent,” the IRS said. “Since petitioners’ conduct is nothing less than dilatory, petitioners should be barred from submitting Kucik’s expert report.”

What’s more, VHC cannot rely on the report because they weren’t aware of the financial condition of ST Paper when it claimed the bad debt deductions at issue.

“The test is based on what the taxpayer knew at the time, not what the taxpayer found out years after the debt is written off,” the IRS wrote.

The case is scheduled for trial on Aug. 15 in Milwaukee. VHC could not be reached Monday for comment on the motion. The IRS does not comment on pending litigaiton.

In its March 2015 **petition**, VHC said that it owned debt and not equity in relative Ron Van Den Heuvel's spinoff businesses and that the IRS wrongly increased VHC's taxable income during the period while disallowing deductions for the debt, which a series of bad deals had rendered illiquid.

Though VHC declined Ron's solicitations to invest in businesses under his control, VHC began issuing debt in the form of promissory notes to Ron's acquired companies for equipment and overhead costs.

Shortly before 2000, VHC issued a line of credit to Ron'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 Ron Van Den Heuvel's assets. Believing that 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.

VHC is represented by Robert M. Romashko, Robert E. Dallman, Daniel B. Geraghty, Thomas R. Vance and Patrick S. Coffey of Husch Blackwell LLP.

The IRS is represented by Christa A. Gruber.

The case is VHC Inc. et al v. Commissioner of Internal Revenue, case number 004756-15, in U.S. Tax Court.

--Editing by Patricia K. Cole.
