

# Bond Case Briefs

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## **TAX - LOUISIANA**

### **2590 Associates, LLC v. Commissioner of Internal Revenue**

**United States Tax Court - January 31, 2019 - T.C. Memo. 2019-3 - 2019 WL 413619 - 117 T.C.M. (CCH) 1010**

Tax matters partner for limited liability company (LLC) treated as a partnership for federal taxation purposes petitioned for review of final partnership administrative adjustment (FPAA) which denied worthless debt deduction for bridge loan to developer that developer had failed to repay.

The Tax Court held that:

- LLC was entitled to claim worthless debt deduction;
- State law supported finding that lender's transfer of debt to LLC did not negate legitimacy of the debt; and
- Debt became worthless in tax year in which private activity bonds were terminated and district court dismissed developer's counterclaims and affirmative defenses in foreclosure case.

Individual lender's transfer of debt, a bridge loan he had extended to property developer, to limited liability company (LLC) in exchange for equity interest therein did not negate the legitimacy of the debt, and thus, debt was bona fide and LLC could claim a worthless debt deduction when developer defaulted on repayment of the loan; transaction postponed need for development company to repay the debt, it did not discharge the debt, and while the development company and LLC had common, related owners, they did not have identity of ownership, and further, bona fide debt existed between development company and LLC, since LLC held a promissory note with a fixed maturity date and accrued interest at above-market rate, interest increased upon default, and at time of note's transfer, LLC fully intended to collect the debt from development company.

State law supported finding that individual lender's transfer of debt, a construction bridge loan to developer, to limited liability company (LLC) in exchange for equity interest therein did not negate the legitimacy of the debt, for purposes of LLC's claimed worthless debt deduction when developer defaulted on repayment of the loan; the underlying debt continued to exist, as there was no novation, as required by state law to release debtor of its liability to a creditor, but rather, a creditor's valid assignment of a promissory note.

Bridge loan to developer for construction project became worthless, for purposes of worthless debt deduction from income taxes, not in tax year that foreclosure proceedings were started or in tax year when final judgment of foreclosure was issued, but rather, in tax year in which private activity bonds were terminated, since note had value at beginning of that year, and with termination of the bonds, developer did not see viable means to obtain refinancing of the project, and also, the developer's negotiations to avoid foreclosure broke down in that year and the district court dismissed developer's counterclaims and affirmative defenses in the foreclosure case.