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Eleventh Circuit: Taxpayer denied losses from S corporation's indebtedness

The U.S. Court of Appeals for the Eleventh Circuit today affirmed a memorandum opinion of the U.S. Tax Court that disallowed losses claimed by the taxpayer with regard to S corporation indebtedness.

The case is: *Meruelo v. Commissioner*, 18-11909 (11th Cir. May 6, 2019). Read the Eleventh Circuit's [decision](#) [PDF 100 KB]

Summary

The taxpayer (an individual) was a shareholder (holding 49% of the stock) of an S corporation that was involved in Florida real estate. The company suffered approximately \$27 million in losses after banks foreclosed on its condominium complex. The taxpayer:

- Asserted that he had a sufficient basis in the company's indebtedness for him to deduct \$13 million as his share of the loss
- Claimed basis from a \$5 million capital contribution he made to the company and more than \$9 million of indebtedness from net transfers through various other business entities in which he held an interest

The IRS determined that the taxpayer could claim only the \$5 million basis—and not the \$9 million—because any debt ran from the company to the other business entities.

The Tax Court determined that the taxpayer had failed to establish a bona fide indebtedness of \$9 million running directly to him and further that he had failed to establish that he had made an "actual economic outlay" toward the debt.

The Eleventh Circuit today affirmed the Tax Court, after determining that the issue was whether monetary transfers between various business entities partly owned by the taxpayer and an S corporation that were later reclassified as loans from the taxpayer to the S corporation established a "bona fide indebtedness" that "runs directly" to the taxpayer. The Eleventh Circuit held that the Tax

Court had correctly determined that the taxpayer did not establish a bona fide indebtedness that ran directly to him.

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