

## ***Porreca v. Commissioner, 88 T. C. 835 (1987)***

An investor is not at risk under section 465 for the principal amount of promissory notes if the notes are effectively nonrecourse due to minimal payments and conversion options, and investments lacking a profit motive do not qualify for tax deductions under section 183.

### **Summary**

Joseph Porreca invested in television programs through Bravo Productions, Inc. , using promissory notes labeled as recourse but with a conversion option to nonrecourse after five years. The Tax Court held that Porreca was not at risk under section 465 for the principal amounts due to the minimal payment requirements and the conversion option, which effectively immunized him from economic loss. Additionally, the court found that Porreca’s investments lacked a profit motive under section 183, as they were primarily for tax benefits, resulting in the disallowance of claimed deductions for depreciation, management fees, and interest.

### **Facts**

Joseph Porreca purchased six episodes of two television programs produced by Bravo Productions, Inc. (Bravo): three episodes of “Sports Scrapbook” in 1979 and three episodes of “Woman’s Digest” in 1980. The purchase price for each episode was paid partially in cash and partially through promissory notes labeled as recourse. These notes required minimal annual interest payments during the initial five-year term, and after this term, Porreca could convert them to nonrecourse liabilities upon payment of a nominal fee. Bravo’s efforts to collect on delinquent payments were minimal, and the programs generated little to no income.

### **Procedural History**

The Commissioner of Internal Revenue determined deficiencies in Porreca’s Federal income tax liabilities for the years 1979, 1980, and 1981, disallowing deductions related to his investments in the television programs. Porreca filed a petition with the Tax Court, which held a trial and subsequently issued an opinion disallowing the deductions based on the at-risk rules and lack of profit motive.

### **Issue(s)**

1. Whether Porreca was at risk within the meaning of section 465 for the principal amount of the promissory notes issued to Bravo.
2. Whether Porreca’s investments in the television programs were made with the intention of earning a profit within the meaning of section 183.

### **Holding**

1. No, because the promissory notes, although labeled as recourse, effectively

immunized Porreca from economic loss due to minimal payment requirements and a conversion option to nonrecourse liabilities after five years.

2. No, because Porreca's investments were primarily motivated by tax benefits rather than a legitimate profit motive, as evidenced by his lack of investigation into the investment's profit potential and the poor performance of the programs.

### **Court's Reasoning**

The Tax Court analyzed section 465, which limits deductions to the amount the taxpayer is at risk. The court found that the promissory notes did not genuinely expose Porreca to economic risk due to the minimal payments required during the initial term and the conversion option to nonrecourse after five years, which was not tied to any substantial economic event. The court referenced legislative history and case law to support its interpretation of "other similar arrangements" under section 465(b)(4), concluding that the structure of the notes effectively protected Porreca from economic loss.

For the profit motive issue under section 183, the court applied a multifactor test, considering Porreca's lack of investigation into the investment's merits, reliance on unqualified advice, and the poor content and performance of the programs. The court concluded that Porreca's primary motivation was tax benefits, not profit, and thus disallowed the deductions.

The court also addressed Porreca's alternative argument that interest payments should be treated as capital expenditures if not at risk, rejecting it as inconsistent with the court's findings on the at-risk and profit motive issues.

### **Practical Implications**

This decision reinforces the importance of genuine economic risk in tax shelter investments under section 465, emphasizing that the substance of financing arrangements will prevail over their form. Tax practitioners must carefully structure investments to ensure investors are genuinely at risk to avoid disallowance of deductions.

The ruling also underscores the need for a bona fide profit motive in investments to claim deductions under section 183. Investors and their advisors should conduct thorough due diligence and document a clear profit-oriented intent to support such claims.

Subsequent cases have cited Porreca in analyzing similar tax shelter arrangements, particularly those involving promissory notes with conversion features. The decision has influenced tax planning strategies, prompting more scrutiny of investment structures and the documentation of profit motives in tax-related litigation.