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In re Kossoff PLLC: Takeaways for SMB Lenders and Funders

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KEY POINTS

- In *In re Kossoff PLLC*, a bankruptcy court recharacterized 19 merchant cash advance agreements as usurious loans under New York law despite contractual disclaimers to the contrary.
- New York courts apply a three-factor test examining reconciliation, finite term, and bankruptcy recourse to determine whether a revenue-based financing is actually a loan.
- Contractual labels such as "THIS IS NOT A LOAN" will not prevent recharacterization where the economic substance of a revenue-based financing agreement operates as a loan.

Revenue-based financing has long been a reliable alternative for small and medium-sized businesses (SMBs) seeking financing, especially when traditional financing might not be available. When entering into a revenue-based financing, the SMB receives funding in exchange for an agreed-upon percentage of the SMB's future receivables. Financings under this model are not characterized by, and are generally not considered, "loans" that are subject to usury and other laws that apply to traditional loans. However, courts are increasingly scrutinizing revenue-based funding when it looks like a traditional loan. In other words, courts are more frequently saying "if it looks like a loan, walks like a loan, and quacks like a loan, it's probably a loan."

The most recent example of this trend can be seen in the court's decision in *In re Kossoff PLLC*, 2026 WL 2168916 (Bankr. S.D.N.Y. July 27, 2026). This decision — and others like it — serves as a stark reminder to SMB funders that they cannot simply call a loan a "revenue-based financing," and expect a court (or their customers) to treat it as such.

IN RE KOSSOFF: BACKGROUND

Kossoff PLLC was a law firm that entered into 19 revenue-based financing agreements (also called merchant cash advance (MCA) agreements) with funder Capital Stack, receiving approximately $10.88 million in exchange for a total repayment obligation of roughly $14.88 million — a 37% premium. When the firm's sole managing member misappropriated funds and the firm was forced into Chapter 7 bankruptcy, the bankruptcy trustee sought a declaration that the MCA agreements were actually loans under New York law, which would allow the trustee to seek to void the transactions as usurious and recover amounts for the estate.

Capital Stack defended against the trustee's claim on a familiar ground: the agreements were expressly titled "Agreement for the Purchase and Sale of Future Receipts," included disclaimers stating that they were not loans, and the funding and repayment obligations were structured as purchases of future receivables. The trustee countered that regardless of how the documents were labeled, the economic substance of the deals operated like loans.

HOW THE COURT DECIDED: A THREE-FACTOR TEST

Under New York law, courts will look past the labels parties put on their agreements and examine the economic substance of the transaction. The leading test is articulated in *LG Funding, LLC v. United Senior Props. of Olathe, LLC*, 181 A.D.3d 664 (2d Dep't 2020), which focuses on three factors:

1. **Reconciliation:** Does the agreement *require*, or simply just permit, the funder to adjust the payment amounts based on the actual receipts of the SMB?
2. **Term:** Does the agreement have a finite term, like a traditional loan, or does it genuinely last until repayment based on variable revenue?
3. **Bankruptcy Recourse:** If the SMB files for bankruptcy, does the funder retain remedies to essentially guarantee repayment?

If the answer to all three of these factors is "yes," then the funding agreement will be characterized as a loan. In *In re Kossoff,* the court found that each of the three *LG Funding* factors applied to the transactions at issue, and thus the "revenue-based financings" should be treated as loans.

1. First, the reconciliation provision in each of the agreements was illusory because any adjustment to the payments was entirely in Capital Stack's discretion; the agreements imposed no binding obligation on Capital Stack to honor adjustment requests and provided no mechanism to refund prior overcollections.
2. Second, the agreements included mandatory daily ACH remittances and provided for automatic default upon a missed payment, allowing the repayment period to be calculated with mathematical certainty. This is a hallmark of a loan rather than a genuine sale of future receivables.
3. Third, the carve-out that allowed the merchant to miss payments due to bankruptcy provided no meaningful protection because it applied only when the merchant had not already defaulted under the agreement. The court reasoned that, due to the broad default provision, any merchant filing bankruptcy was virtually certain to have already defaulted.

The court identified other red flags: the agreements failed to describe the specific receivables being purchased, Capital Stack had no direct collection rights against the merchant's customers, and the daily payment amounts were untethered to actual receipts. Together, these features reinforced that the transactions actually operated as loans.

LOOKING AHEAD

The *Kossoff* decision represents a continuation of the broader judicial trend toward rigorous substance-over-form analysis of revenue-based financing transactions. Contractual labels such as "THIS IS NOT A LOAN" will not shield an agreement from recharacterization where the economic substance suggests that it is a loan. For SMB funders and lenders, this decision underscores the importance of understanding how courts may view revenue-based financing structures — particularly provisions relating to reconciliation, payment terms, default remedies, and bankruptcy treatment.

For guidance on revenue-based financing structures, MCA agreement compliance, or related financial services litigation matters, please contact the authors of this article.

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