Taxation of Debt Instruments and Securitization Transactions

LAWG – 980 – 10

LAWJ – 980 – 09

Georgetown University Law Center

Spring Semester 2017

Professors Mayo and Keinan

COURSE DESCRIPTION

The course will explore selected federal income tax issues involved with debt instruments. Major topics will include the legal and economic characteristics of indebtedness, distinguishing between debt and equity, the fundamentals of the original issue discount rules, market discount and bond premium, sale, exchange, redemption and modification of debt instruments, variable rate and contingent payment debt instruments, and Wall Street hybrids.

COURSE OBJECTIVES

The course has two objectives. First, it seeks to help students understand the legal framework for the federal income tax rules that apply to the issuance and ownership of debt instruments. Second, it seeks to help students in the practical application of these rules.

CLASS FORMAT AND ATTENDANCE

Class sessions will consist primarily of lectures and group discussion.

GRADING AND REQUIREMENTS

Requirements: Students will be required to read 1-2 chapters from the Garlock Treatise (see below) prior to each class. The course will have a take-home final exam.

Grade: A student’s grade will be based on the final exam, though class participation may also be considered in appropriate circumstances.
READING MATERIAL


ISSUES AND ASSIGNED READINGS

Session 1

1. What Is Indebtedness? (Garlock, Primer, Ch. 1, subchapters 1.01, 1.02)
   a. Contrast “indebtedness,” “liability” and “obligation.”
   b. Situations where debt is deemed to exist
   c. Debt v. equity
   d. Nonrecourse debt
   e. Debt v. lease
   f. Debt v. sale of future income
   g. Debt v. annuity
   h. Debt v. prepayment for services
   i. Whose debt is it?
   j. Overview of the Treasury Regulations under Section 385

Session 2

2. Basic Debt Instrument Economics
   a. Compound interest
   b. Present and future value
   c. Yield to maturity

3. Determining Whether a Debt Instrument Has Original Issue Discount (OID)
(Garlock, Ch. 2, subchapters 2.01, 2.02, 2.03, 2.04[0.1])
   a. Stated redemption price at maturity and qualified stated interest
   b. Issue price
   c. De minimis OID

Session 3

4. How OID Accrues (Garlock, Ch. 5, subchapters 5.01, 5.02, 5.03, 5.04, 5.05, 5.06, 5.08, 5.10, 5.11)
   a. Accrual periods
   b. Allocation of OID to accrual periods
   c. Daily portions of OID
   d. Special cases
      i. Stepped interest rates
      ii. Puts and calls
      iii. Convertibles and investment units
e. Acquisition premium

5. The OID Anti-abuse Rule (Garlock, Ch. 5.15)
   a. Statement of the Rule
   b. Potential applications

Session 4

6. Market Discount (Garlock, Ch. 11, subchapters 11.01, 11.02, 11.03[0.1] and [0.2], 11.04[0.1] and [0.2], 11.05[0.1], [0.1] and [0.3])
   a. Definition of market discount
   b. \textit{De minimis} rule
   c. Basic market discount rules
   d. Computing accrued market discount
   e. Recognition of market discount
   f. Deferral of interest deductions allocable to accrued market discount

7. Bond Premium (Garlock, Ch. 12, subchapters 12.01, 12.02[0.1], [0.2], 12.03)
   a. Basic rules adopt OID principles
   b. Different rule for holders and issuers

Session 5

8. Imputed Interest Rules – Section 1274 (Garlock, Ch. 3, subchapters 3.01, 3.02, 3.03, 3.04)
   a. Historical background
   b. Applicable federal rates and adequate stated interest
   c. Imputed interest computations

9. Variable Rate Debt Instruments (VRDIs) (Garlock, Ch. 8, subchapters 8.01, 8.02, 8.03, 8.04, 8.05, 8.06)
   a. Definition of VRDI and QFR
   b. Accrual of interest and OID

Session 6

10. Contingent Payment Debt Instruments (CPDIs) (Garlock, Ch. 9, subchapters 9.01, 9.02, 9.03 [0.1] and [0.2], 9.04[0.1] through [0.4], 9.05[0.1] through [0.5])
    a. Historical background
    b. The noncontingent bond method
       i. Scope and overview
       ii. Comparable yield
       iii. Projected payment schedule
       iv. Positive and negative adjustments
       v. Sales, redemptions, and other dispositions.
c. Contingent debt issued for property
   i. Interest accruals under the CPDI regulations
   ii. Imputed interest, basis and amount realized issues

Session 7

11. Hedging of Debt Instruments (Garlock Ch. 17.01, 17.02)
12. Integration of Debt Instrument and Derivative (Garlock, Ch. 17.03)
   a. Definitions and qualifications
   b. Taxation of integrated transaction
   c. Legging in and legging out

Session 8

13. Limitations on Interest Deductions (Garlock, Ch. 6.01, 6.02, 6.06, 6.07, 6.08).
   a. Debt used to purchase or carry tax-exempt bonds
   b. Section 163(l)
   c. High yield discount obligations
   d. Straddle interest (section 263(g))

Session 9

14. Coupon Stripping (Garlock, Ch. 18, subchapters 18.01, 18.02, 18.03, 18.04)
   a. Historical background
   b. Treatment of the purchaser of a stripped coupon or bond
   c. Treatment of a person stripping a bond
   d. Character issues

15. Short-Term Obligations (Garlock, Ch. 7, subchapters 7.01 through 7.04)
   a. Government obligations
   b. Nongovernmental obligations
   c. Interest deferral rules

Session 10

16. Wall Street Hybrids (Garlock, Ch. 9.07)
   a. Debt plus forward on issuer stock: Feline PRIDES, etc.
   b. Contingent convertibles
   c. Convertible plus call spread
   d. TLAC and Rev. Proc. 2017-12

Session 11
17. Debt Modifications (Garlock, Ch. 14, subchapters 14.01, 14.02, 14.03, 14.04, 14.05)
   a. Historical background – early cases and *Cottage Savings*
   b. Modifications
   c. Significant modifications
   d. Debt workouts

18. Redemptions (Garlock, Ch. 13, subchapters 13.01, 13.02, 13.03, 13.05)
   a. Premium deductible by issuer, capital gain to holder
   b. Debt repurchased at a discount
   c. Related party debt acquisitions at a discount

**Session 12**

19. Cross border Issues
   a. 2016 Treasury Regulations under Section 385
   b. U.S. taxation of interest earned by non-U.S. persons
   c. Portfolio interest exemption
   d. Treaty considerations