

First proposed regs. under § 385 (withdrawn)

- If “debt” = stock, it was preferred stock
- Tested debt only when issued; re-tested only if terms changed or debt not paid when due
- D:E “safe harbors”= 10:1 total and 3:1 inside
- Used *basis* of assets for D:E calculations

2016 final regs. under § 385

- Designed to stop international tax avoidance by large and/or public corporations
- Stop “stripping” of U.S. earnings by paying interest to related foreign corporations
- Focused on related-party debt
- Controversial
- IRC § 163(j) now provides limits

Gain/loss on sale of stock

- Capital gain/loss = gain/loss on sale/exchange of a capital asset
- Capital asset? IRC § 1221
 - Stock = capital asset
 - except for broker-dealers selling to customers
 - except for traders electing to be treated as dealers
 - dealers “mark to market”

Exceptions

- Gain: IRC § 1202
 - Exclusion
- Loss: IRC § 1244
 - Ordinary loss even for nondealer

Worthless stock

- Capital gain/loss = gain/loss on sale/exchange of a capital asset
- IRC § 165(g)

Gain/loss on sale of debt

- Capital gain/loss = gain/loss on sale/exchange of a capital asset
- Capital asset? IRC § 1221
 - Stock = capital asset
 - except for dealers selling to customers (e.g., mortgage broker)
 - except for traders electing to be treated as dealers
 - dealers “mark to market”

Worthless debt

- “Security”?
 - IRC § 165(g) = Capital loss
- Non-“security”
 - Corporate holder gets ordinary loss per IRC § 166(a)(1)
 - Noncorporate holder - IRC § 166(d)
 - Business bad debt is ordinary loss
 - Nonbusiness bad debt is capital loss