

Interest and Debt

Key Tax Issues

Course Description

This course brings the practitioner up-to-date information on tax issues affecting interest and debt. It covers the definition of bona fide debt, the avoidance of equity and lease treatment, imputed interest rates and debt modification. The various types of interest and their required allocation are explored and reviewed. For the economically troubled client, special attention is devoted to debt cancellation, repossession, discounts, and foreclosure. The program also discusses installment sales, equity participation debt, taxable interest, and bad debts.

Completion Deadline & Exam: This course, including the examination, must be completed within one year of the date of purchase. In addition, unless otherwise indicated, no correct or incorrect feedback for any exam question will be provided.

Course Level: Overview. This program is appropriate for professionals at all organizational levels.

CPE Credits: 18 (CPA, EA)

Category: Taxation

Prerequisite: General understanding of federal income taxation.

Advanced Preparation: None

Course Learning Objectives

Chapter 1 Deductible Interest & Debt

1. Determine "interest" and select how much is tax deductible under §163 by:
 - a. Identifying what constitutes bona fide debt considering economic substance and purpose and specifying how transactions with family members and controlled corporations can recharacterize alleged indebtedness into gift or business equity noting the factors used in this recharacterization; and
 - b. Specify the incentives to use corporate debt instead of equity, recognizing the special treatment of failed equity investment under §1244, and determining the differences among debt from installment sales, long-term and leveraged leases, and annuities.
2. Identify deductible interest noting special calculation concepts and procedures by:

- a. Recognizing the allocation of interest based on the debt's purpose noting the application of any carryover rules and determining net investment income noting its relationship investment interest deduction; and
 - b. Identifying the special tax treatment given to student loans, margin accounts, and market discount bonds noting what happens to any disallowed interest expense and specifying the timing considerations in interest reporting including interest paid in advance.
3. Identify nondeductible interest noting provisions that deny or restrict the deduction of interest by:
 - a. Recognizing when interest is nondeductible personal interest under §163(h)(1) and identifying the disallowance of interest related to tax-exempt income under §265, the life insurance interest restrictions of §264; the §465 at-risk limitations and the application of the §469 passive loss rules; and
 - b. Specifying the treatment of commitment fees and service charges based on R.R. 67-2897 and case law.
4. Recognize the deduction of interest using either the cash method or accrual method, determine the special elections applicable to and treatment of carrying charges under §266, below-market loans, imputed interest and original issue discount.

Chapter 2: Allocation of Deductible Interest

1. Determine the allocation of deductible interest based on the use and repayment of the loan proceeds and identify the special rules for the allocation of interest expense in connection with debt-financed acquisitions of, and distributions from, partnerships and S corporations.

Chapter 3: Home Mortgage Interest

1. Identify categories of mortgages and characteristics of secured debt that influence the deductibility of interest, "qualified home," and special situations affecting mortgage interest.
2. Specify special situations that can impact the qualified home mortgage interest deduction.
3. Recognize the general rule for the tax treatment of points noting exceptions, determine when a taxpayer will receive a Mortgage Interest Statement – Form 1098 and which information is included on this statement to figure interest deductions.
4. Identify when a stock in a cooperative housing corporation owned by a tenant-stockholder is a qualified home allowing for a deduction of interest paid, and specify the limits on the home mortgage deduction to ensure that appropriate deductions are taken.

Chapter 4: Taxable Interest

1. Identify distinctions between dividends and interest noting the taxability of interest on CDs, deferred interest accounts, frozen deposits, and U.S. obligations and specify the treatment of other miscellaneous interest items.
2. Recognize the types of U.S. savings bonds noting their tax advantages and disadvantages, identify the tax treatment of bonds sold between interest dates, and determine when life insurance proceeds are taxable or excludable from income.
3. Identify state and local government debt obligations noting the nature of the activity they fund and their impact on whether the interest received from them is taxable.

Chapter 5: Installment Sales

1. Recognize the importance of the installment method, and specify §453 requirements and basic terminology associated with using the installment method.
2. Determine the impact of §483 (imputed interest rules) and §§1271 through 1274 (original issue discount rules) on installment sales, and identify the §1038 repossession rules that apply to repossessions by sellers and repossessions of principal residences.
3. Specify the rules associated with real property sales and casual sales of personalty, the provisions associated with the related party rules of §453 and the exceptions that override basic installment planning, identify regulations governing like-kind exchanges noting their impact on delayed exchanges and recognize the development and application the contingent payment rules.
4. Determine the allocation of payments for a single sale of several assets among different classes according to R.R. 76-110, identify the §1060 residual method to report the sale of a business, and identify “dealer dispositions” noting when installment reporting may not be used.
5. Recognize the interest payable on installment dispositions exceeding \$5 million and specify the circumstances when dispositions of installment obligations occur.

Chapter 6: Repossession

1. Identify the variables that determine which §1038 rules for repossessions apply, and determine basis and gain or loss resulting from repossession of personal property using installment method and the non-installment method sales.
2. Specify the distinctions between the rules, calculations and effects of repossessions of personal and real property, and identify when a §166 bad debt deduction may be taken if the seller repossesses real property.

Chapter 7: Debt Cancellation & Foreclosure

1. Recognize the effect that debt cancellation has on net worth and potential income inclusion from cancellation of indebtedness income, and specify exceptions to the general income inclusion rule noting tax impact.
2. Identify tax attribute reductions noting their application when reducing canceled debt, cite the special basis reduction rules, recognize the depreciable property election in reducing the basis of depreciable property before reducing any other tax attributes, determine what constitutes individual, partnership and S corporation bankruptcy, and specify the variables used in determining whether shares of stock issued to a creditor are nominal or token.
3. Determine gain or loss resulting from foreclosure or repossession, noting reporting and filing requirements, specify the timing and character of the gain or loss, and cite the hidden income tax danger of directly or indirectly acquiring one's own debt at a discount.

Chapter 8: Equity Participation Debt

1. Recognize the mechanics of equity participation debt noting the use of this financing option to clients by:
 - a. Identifying equity participation loans noting the lender's role in each and common elements and six characteristics of shared appreciation loans noting key terms; and
 - b. Specify the economic aspects of shared appreciation mortgages including the tax treatment of shared appreciation mortgages based on the hybrid concept and R.R. 83-51.
2. Determine the types of equity participation debt by:
 - a. Specifying three basic tests for loans where "interest" is measured in whole or in part by equity participation, the importance of the Culbertson rule and the risk of partnership status;
 - b. Identifying the tax consequences of being a property owner and the recharacterization of debt based on the failure to find a debtor-creditor relationship between the borrower and lender; and
 - c. Specifying the conversion and option rights associated with equity participation debt noting the application to debt instruments of the time value of money provisions of imputed interest and original issue discount.

Chapter 9: Foreign Interest Withholding

1. Recognizing the general tax treatment of interest received from sources within the United States, and identify the tax treatment of foreign interest by:

- a. Specifying types of interest paid to foreign payees that are subject to withholding noting how to figure the tax;
- b. Identifying the requirements of tax treaties to ensure entitlement to benefits under the tax treaty and specifying statutory withholding rates for tax-free covenant bond interest; and
- c. Determining the types of interest of U.S. obligors that are not subject to withholding and the conditions of their exemption.

Chapter 10: Bad Debts

1. Identify bad debt categories noting their tax treatment and effect on accounting and reporting by:
 - a. Determining the concepts of worthlessness and true debt including the unique characteristics of deductible nonbusiness bad debt;
 - b. Recognizing the treatment of bad debts related to political debts, mechanics' liens and secondary liabilities on home mortgages; and
 - c. Specifying the forms used to report bad debts and the tax treatment of recovered amounts.
2. Determine the §166 tax treatment of business bad debts by:
 - a. Identifying the tax treatment of business credit transactions, loan guarantees, accounts receivable or notes receivable particularly the tax treatment of accounts receivable in a business sale and specifying the various forms on which a bad debt deduction should be taken depending on the entity type;
 - b. Recognizing the tests that must be met by an accrual method business taxpayer to be able to take a bad debt deduction for a political debt and identifying the tax consequences of the insolvency of a partner when a business partnership terminates and debts are owed; and
 - c. Specifying methods that can be used by businesses to treat uncollectible amounts noting the rules that apply to each.