TAXATION OF FINANCIAL INSTRUMENTS
Spring 2014
Omri Marian

General Information, Class Policies, First Day Assignments

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Class schedule and location: Thursdays, 8:30 am – 10:40 am, room 355C.
Office hours: Thursdays, 10:40 am – 12:40 pm, and by appointment.

Course objectives: Financial instruments are present in our everyday lives (in our student loans, home-mortgage, car-lease and in our bank deposits, to name a few), and are an integral part of any commercial transaction (such as in credit arrangements, commercial loans, incentive compensation plans, and securities offerings). The course is aimed at providing an overview of U.S. federal income taxation of financial instruments and their building blocks, including debt instruments, options, futures, forward, swaps and structured derivatives. It is assumed that students have no prior knowledge in finance. We will therefor explore basic themes in finance to the extent relevant to the subjects discussed.

We will start with an introductory session and discuss the basic building blocks of financial instruments, their basic tax treatments, as well as the tax considerations at play.

In Unit 1 we will discuss the tax treatment of debt instruments. We will explore concepts related to the time value of money, the distinction between debt and non-debt instruments, and the ramification of such distinctions. We will also discuss the tax treatment of certain types of structured debt instruments, such as contingent payment debt instruments and variable rate debt instruments.

Unit 2 will be dedicated to the tax treatment of financial derivatives such as options, forwards, futures, swaps and certain common types structured financial instruments (such as “variable prepaid forward contracts” and “reverse convertibles”). We also will discuss how taxpayers use financial innovation to their advantage, as well as Congress’s and Treasury’s attempt to battle schemes that are perceived abusive. In this context we will explore issues relating to wash sales, short sales, constructive sales, straddles and hedging transactions.

Unit 3 will explore miscellaneous issues such as the taxing rules applicable to dealers in securities and other financial institutions, as well as foreign currency transactions.

Grading and Exam: 90 percent of your grade in the course will be based on anonymously graded two and a half hour final examination. The exam will be open-book. You will be allowed to bring in any book (printed-form only!) as well as any self-prepared notes. Code and Treasury
Regulations are also recommended (you will be allowed online access to the Code and Regulation thru Lexis, Westlaw, CCH IntelliConnect or RIA Checkpoint). 10 percent of your grade will be based on class participation, accorded at my discretion. Class participation grade must be earned. If you did not participate at all throughout the semester you should expect to get zero points for the participation component.

The College of Law grading policies can be found at: http://www.law.ufl.edu/student-affairs/current-students.academic-policies#9.

**Texts:** I will assign reading from two treatises that are available online (do not purchase these texts):

- Bittker & Lokken, Federal Taxation of Income, Estates & Gifts (B&L). This treatise is available online at RIA CheckPoint.
- Garlock, Federal Income Taxation of Debt Instruments (Garlock). This treatise is available online at CCH Intelliconnct.

**Other course materials, TWEN access:** Problem sets and additional reading materials will be provided through the course website on TWEN. It is essential that you register to the course website on TWEN as soon as possible. The password for the course website is posted on the message board outside my office.

**Class materials; Laptop/Tablet policy:** Laptops and tablets are allowed (in fact, they are recommended). Please use responsibly. Please bring to each class the reading materials assigned. You should also have in-class access to the full set of the Code and Treasury Regulations.

**Problems sets; Class preparation:** Assignments may be discussed over the course of more (or less) than one class. The review of the assigned problems will, in most cases, be integrated with the lecture. Students are expected to discuss their proposed answers in class voluntarily, but I will cold-call to the extent necessary.

In case you are unprepared for class, and you are being called in class, you may pass the question. *You are allowed a maximum of two passes during the semester without affecting your final grade.* In case you are unprepared for class and prefer not to pass in the presence of your classmates, you may elect in advance to pass cold-calls by letting me know you are passing (by e-mail or in person) the morning of the day of the class. *There is no need to provide an excuse.* In such a case, I will not call you in class (such a pass will be counted, however, towards your two-pass limit). Passing more than two times during the semester will harm your class-participation component of the grade (meaning, in will reduce your earned participation grade). Wrong, yet at
least minimally thoughtful answers will not harm your participation grade (but it is also likely they will not increase your participation grade). Wrong but thoughtful answers will be viewed favorably for purposes of the participation component.

**Attendance:** Attendance is mandatory. I will not verify attendance in class. However, if I notice your absence, it will be counted towards your two-pass limit. I will generally approve additional absences (that won’t be counted towards the two-pass limit) only in cases of job-interviews, confirmed sick days, or non-frivolous personal reasons. Advance notice will be appreciated.

**Accommodations for students with disabilities:** Students requesting classroom accommodation must first register with the Office of Disability Resources. The UF Office of Disability Resources will provide documentation to the student who must then provide such documentation to the Law School Office of Student Affairs when requesting accommodation.

**First Day Assignment**

**Assignment 1**

*Topics covered:*

- Introduction to the building block of financial derivatives: Debt, Equity, Forwards Futures and Options.
- Introduction to basic tax considerations relating to financial instruments.

*Reading:*

- **B&L:** §§ 53.1, 53.2, 57.1.
- **Code:** §§ 1234; 1234A. Skim §§ 1256(a), (b), (g)(1) & (7); 475(a), (b)(1)(A), (b)(2) & (c)(1).
- **Regulations:** § 1.1234-1 & -3. Skim §§ 1.446-3(c)(1)-(3);
- **Other Materials:** Rev. Rul. 78-182.
- **Problem Set A1** (will be posted on TWEN)

**Future Assignments**

Each assignment will be posted on TWEN at least a week prior to class discussion of the subject matter. However, for purposes of the completeness of the topics covered in the course, the tentative list of the assignments is as follows:

1. **Assignment 1** (see *supra*) – The building block of financial instruments and their tax treatment in general
**Unit 1**
2. Assignment 2 – Fixed rate debt instruments: Tax treatment of OID, market discount, and bond premium
3. Assignment 3 – Structured debt instruments: Step-up notes; Contingent Payment Debt Instruments (CPDIs); Variable Rate Debt Instruments (VRDIs)
4. Assignment 4 – Sale and exchange of debt instruments; debt modifications

**Unit 2**
5. Assignment 5 – Taxation of “naked” non-debt derivatives: Options, 1256 contracts, Notional Principal Contracts (NPCs)
6. Assignment 6 – taxation of structured derivatives: prepaid forwards, reverses convertibles and other structured instruments
7. Assignment 7 – Anti abuse rules: wash sales, short sales, constructive sales and straddles
8. Assignment 8 – Taxation of hedging transactions

**Unit 3 (time permitting)**
9. Assignment 9 – Foreign currency transactions
10. Assignment 10 – Introduction to mark-to-market accounting