

Ajay Gupta

University of Houston Law Center  
Financial Products Taxation  
Spring 2023  
Course Syllabus

1. **Purpose of this Syllabus.** The purpose of this syllabus is to provide details of how this course will proceed, including what you should expect in terms of readings and during class, how I will grade you, and when I will be available to answer questions you may have.

2. **Introduction, Learning Objectives, and Prerequisites.** The course is perhaps best introduced by posing and answering the following questions:

Why did Compaq Computer Corporation buy 10 million shares of Royal Dutch Petroleum Company worth over \$800 million on the New York Stock Exchange, only to trade them back to the seller within the hour? Why did Estée Lauder borrow from her son 5.5 million shares of her company that he then owned, only to sell them in the company's IPO for over \$135 million?

The short answer to both these questions is, of course, tax. The long answer to these and other similar questions about seemingly perplexing investor behavior will occupy us in this course on the taxation of financial products—stocks, bonds, calls, puts, and other more exotic derivatives.

At the end of the course, you should have a through grasp of the principles underlying the tax treatment of basic financial instruments, whether those with fixed payoffs or contingent assets, the possible use of these instruments to circumvent the realization requirement and thus defer or even eliminate tax, and the rules and reform proposals designed to curb such practices.

The course should be of interest to students looking at careers in either tax planning or controversy. Transactional lawyers will gain from an understanding of how financial products are sought to be used (or abused) to “optimize” the tax characteristics of income—by recasting, for example, returns on equity as those on debt, or fixed returns as contingent returns, or ordinary income as capital gains, or domestic-source income as foreign-source, and so on. Litigators will acquire an

appreciation of the arguments that do and do not work in preserving these tax characteristics when the IRS challenges the form of the transactions.

The only prerequisite for this course is an introductory course in federal income taxation. I assume no prior knowledge regarding the pricing or taxation of financial products.

3. **Course Materials.** There is no required text or casebook. I will email you all the readings and other assignments. The readings will mostly consist of selected portions of two different treatises: Keyes, *Federal Taxation of Financial Instruments & Transactions* (Keyes) and Bittker & Lokken, *Federal Taxation of Income, Estates & Gifts* (B&L), both of which are available on Westlaw, supplemented by extracts from casebooks and corporate finance texts, cases, IRS pronouncements, and journal articles. I will email PDFs of all assigned readings, including those from the two treatises. You will be responsible for looking up the relevant Code and Regulations sections cited in the readings.

4. **Class Sessions, Assignments, and Grading.** The scheduled time for class sessions is 5:30 p.m. to 7:30 p.m., on Thursdays, for a total of 14 class sessions. We will meet in synchronous session via Zoom for some or all of that time most weeks. When we are not meeting via Zoom during the scheduled class time, you will be working on “synchronous assignments”—problems that I will email you in real time, which will require you to apply the concepts introduced in the readings.

I will also assign you other “asynchronous problems,” on which you will work on your own time. You are welcome to discuss these asynchronous problems amongst yourselves and work on them in groups. You won’t be required to turn in solutions to these problems, but I will expect you to come to class prepared to discuss them.

We will spend a lot of our Zoom time discussing the solutions to both the synchronous and asynchronous problems. Your participation in class discussions over the semester will count for half your course grade.

The remaining half of your course grade will reflect your performance on a self-scheduling 24-hour take-home final exam that you can take any time during exam period. That exam will consist of numerical problems a lot like the problems assigned during the semester.

If you are otherwise eligible to do so, you are welcome to exercise the option for receiving a pass/fail grade instead of a quality letter grade.

5. **My Availability.** I will generally be available to answer questions after the end of each class session. You may also make an appointment to meet with me at mutually convenient times. Feel free to contact me by email at [ajguptaemail@gmail.com](mailto:ajguptaemail@gmail.com) or on my cell at (630) 854-7194.

6. **Counseling Options.** Counseling and Psychological Services (CAPS) can help students who are having difficulties managing stress, adjusting to the demands of a professional program, or feeling sad and hopeless. You can reach CAPS online ([www.uh.edu/caps](http://www.uh.edu/caps)) or by calling (713) 743-5454 during and after business hours for routine appointments or if you or someone you know is in crisis. No appointment is necessary for the “Let’s Talk” program, a drop-in consultation service at convenient locations and hours around campus.

7. **Optional Background Materials.** Many standard corporate finance texts provide an excellent introduction to the essential characteristics and standard valuation approaches for most basic financial products. These include Brealey et al., *Principles of Corporate Finance*, ISBN-13: 978-1259144387, and Ross et al., *Fundamentals of Corporate Finance*, ISBN-13: 978-0077861704. You are welcome, but are certainly not required, to refer to them to get a better understanding of the underlying economics of these financial products.

8. **Diversity and Inclusion.** I am committed to ensuring an inclusive online learning space, where you will be treated with respect and dignity, regardless of socio-economic status, age, race, ethnicity, disability, religion, national origin, veteran’s status, sex, sexual orientation, gender identity or expression, marital status, political, religious, or ideological affiliation, or any other attribute. Diversity of thought is just as valued and important as any immutable diverse characteristic. If you feel like your class performance is impacted in any way by your experiences inside or outside of class, please reach out to me. I want to be a resource for you. If you feel more comfortable speaking with someone besides me, you can call Student Services at (713) 743-2182. Finally, I encourage you to bring any issues negatively impacting UHLC’s openness to diversity and inclusion to the Law Center’s Diversity and Inclusion (D&I) committee. The D&I committee’s charge includes “[building] on the Law Center’s strengths as a diverse and inclusive environment.” You can contact the committee directly at [UHLCD&I@uh.edu](mailto:UHLCD&I@uh.edu). Your suggestions are

encouraged and appreciated. Please let me know ways to improve the effectiveness of this course for you personally, or for other students or student groups.

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Tentative Reading List

I have provided below a tentative list of topics that I intend to cover and outlined most of the readings I will be assigning during the semester. I will periodically amend this list to track our actual progress. If you wish to read ahead, I have indicated the relevant sections from the Keyes and B&L treatises and cited the other readings.

**Weeks 1-4: Equity Instruments**

Class Session #1: Distinction Between Debt and Equity

Handout on Capital Structure (including the problems on pages 27-28 and 30-31).

Class Session #2: Stock Distributions

*Eisner v. Macomber*, 252 US 189 (1920).

Keyes ¶¶ 1.01-1.05.

Class Session #3: Dividend Stripping

Keyes ¶¶ 2.01-2.04.

*IES Indus., Inc. v. United States*, 253 F.3d 350 (8th Cir.2001).

*Compaq Computer v. Commissioner*, 277 F.3d 778 (5th Cir. 2001).

Class Session #4: Short Sales

B&L ¶ 50.3.

## **Weeks 5-7: Debt Instruments**

Class Session #5: Original Issue and Market Discount

Original Issue Discount

B&L ¶¶ 53.1-53.5.

Debt Instruments Issued for Property Disposition

B&L ¶¶ 54.1-54.7.

Market Discount

Keyes ¶¶ 8.01-8.06; ¶¶ 10.01-10.03.

Class Session #6: Variable Rate and Contingent Debt Instruments

Keyes ¶¶ 6.01-6.04; ¶¶ 7.01, 7.06-7.07.

Class Session #7: Coupon Stripping

*Helvering v. Horst*, 311 US 112 (1940).

Keyes ¶¶ 10.01-10.03.

## **Weeks 8-9: Options**

Class Session #8: Overview of Options and Put-Call Parity Theorem

Brealey et al., *Principles of Corporate Finance*, pp. 512-560.

Class Session #9: Treatment of Options

Keyes ¶¶ 12.01-12.04.

**Week 10: Marking to Market**

Class Session #10: Section 1256 Contracts

Keyes ¶¶ 13.01-13.07.

**Weeks 11-12: Notional Principal Contracts**

Class Session #11: Interest Rate and Commodity Swaps

Keyes ¶¶ 14.01-14.03.

Class Session #12: Total Return Swaps

Notice 97-66.

Industry Directive on Total Return Swaps (Jan. 14, 2010). Notice 2010-46.

JCT, General Explanation of Tax Legislation Enacted in the 111th Congress (March 2011) (extract).

IRS AM 2012-009.

**Weeks 13-14: Financial Transactions**

Class Session #13: Hedging Transactions and Straddles

B&L ¶¶ 57.5, 57.6.

Class Session #14: Wash Sales and Constructive Sales

B&L ¶ 44.8, 57.8.2.

Rev. Rul. 2003-7, 2003-5 IRB 363.

*Anschutz Co. v. Commissioner*, 135 TC 78 (2010).