Is it Debt or Equity?

Characterization factors for consideration in the U.S. Court of Appeals for the Sixth Circuit.

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Context matters for insolvency and bankruptcy cases. No single factor is determinative.

Note: The following matrix details and allows for high-level comparative analysis across the U.S. Tax Code and two U.S. Court of Appeals for the Sixth Circuit cases. The row alignments identify related concepts rather than identical legal standards. Excerpts are selective and should be read with the opinions' accompanying qualifications and applications. The factors require consideration of the circumstances of each case, and no single factor is determinative.

Income Tax			Bankruptcy	
26 U.S.C. § 385(b)	**Roth Steel**		**AutoStyle**	
Description	**Title**	**Selected Discussion Excerpt**	**Title**	**Selected Discussion Excerpt**
[a]	[b]	[b]	[c]	[c]
§ 385(b)(1): "whether there is a written unconditional promise to pay on demand or on a specified date a sum certain in money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of interest,"	"4. Name Given Instruments Evidencing Indebtedness"	"The absence of notes or other instruments of indebtedness is a strong indication that the advances were capital contributions and not loans. Stinnett's Pontiac Service, Inc. v. Commissioner, 730 F.2d 634, 638 (11th Cir. 1984); Raymond, 511 F.2d at 191; Estate of Mixon, 464 F.2d at 403."	"1. The Names Given to the Instruments"	"The absence of notes or other instruments of indebtedness is a strong indication that the advances were capital contributions and not loans. Roth Steel, 800 F.2d at 631."
	"5. Presence or Absence of Fixed Maturity Date and Schedule of Payments"	"The absence of a fixed maturity date and a fixed obligation to repay indicates that the advances were capital contributions and not loans. Lane, 742 F.2d at 1316; Stinnett's Pontiac, 730 F.2d at 638-39; Raymond, 511 F.2d at 191; Estate of Mixon, 464 F.2d at 404."	"2. The Presence or Absence of a Fixed Maturity Date and Schedule of Payments"	"The absence of a fixed maturity date and a fixed obligation to repay is an indication that the advances were capital contributions and not loans. Ibid. [Roth Steel, 800 F.2d at 631.]"
	"6. Presence or Absence of a Fixed Rate of Interest and Interest Payments"	"The absence of a fixed rate of interest and interest payments is a strong indication that the advances were capital contributions rather than loans. Stinnett's Pontiac, 730 F.2d at 640; Raymond, 511 F.2d at 191; Austin Village, 432 F.2d at 745."	"3. The Presence or Absence of a Fixed Rate of Interest and Interest Payments"	"The absence of a fixed rate of interest and interest payments is a strong indication that the advances were capital contributions rather than loans. Ibid. [Roth Steel, 800 F.2d at 631.]"
§ 385(b)(2): "whether there is subordination to or preference over any indebtedness of the corporation,"	"9. Subordination of Advances"	"Subordination of advances to claims of all other creditors indicates that the advances were capital contributions and not loans. Stinnett's Pontiac, 730 F.2d at 639; Raymond, 511 F.2d at 191; Austin Village, 432 F.2d at 745."	"9. The Extent to Which Advances Were Subordinated to Claims of Outside Creditors"	"Subordination of advances to claims of all other creditors indicates that the advances were capital contributions and not loans. Id. [Roth Steel, 800 F.2d] at 631-32."
§ 385(b)(3): "the ratio of debt to equity of the corporation,"	"2. Adequacy or Inadequacy of Capitalization"	"Thin or inadequate capitalization is strong evidence that the advances are capital contributions rather than loans. See Bauer, 748 F.2d at 1369; see also Estate of Mixon, 464 F.2d at 408; Foresun, 348 F.2d at 1009; Bittker & Eustice, supra, at 4-12."	"5. The Adequacy or Inadequacy of Capitalization"	"Thin or inadequate capitalization is strong evidence that the advances are capital contributions rather than loans. Id. [Roth Steel, 800 F.2d] at 630."
§ 385(b)(4): "whether there is convertibility into the stock of the corporation, and"	No separately enumerated factor heading.	N/A	No separately enumerated factor heading.	N/A
§ 385(b)(5): "the relationship between holdings of stock in the corporation and holdings of the interest in question."	"1. Identity of Interest Between Creditor and Stockholder"	"'If advances are made by stockholders in proportion to their respective stock ownership, an equity contribution is indicated.... A sharply disproportionate ratio between a stockholder's percentage interest in stock and debt is, however, strongly indicative that the debt is bona fide.' Estate of Mixon, 464 F.2d at 409."	"6. The Identity of Interest Between the Creditor and Stockholder"	"If stockholders make advances in proportion to their respective stock ownership, an equity contribution is indicated. Ibid. [Roth Steel, 800 F.2d at 630.]"
Not expressly listed in § 385(b)(1)–(5).	"3. Source of Repayments"	"If the expectation of repayment depends solely on the success of the borrower's business, the transaction has the appearance of a capital contribution. Lane v. United States, 742 F.2d 1311, 1314 (11th Cir. 1984); Estate of Mixon, 464 F.2d at 405."	"4. The Source of Repayments"	"If the expectation of repayment depends solely on the success of the borrower's business, the transaction has the appearance of a capital contribution. Roth Steel, 800 F.2d at 631."
	"7. Presence or Absence of Security"	"The absence of security for the advances is a strong indication that the advances were capital contributions rather than loans. Lane, 742 F.2d at 1317; Raymond, 511 F.2d at 191; Austin Village, 432 F.2d at 745."	"7. The Security for the Advances"	"The absence of a security for an advance is a strong indication that the advances were capital contributions rather than loans. Roth Steel, 800 F.2d at 631."
	"8. Inability to Obtain Outside Financing"	"The fact that no reasonable creditor would have acted in the same manner as the taxpayer is strong evidence that the advances were capital contributions rather than loans. Stinnett's Pontiac, 730 F.2d at 640; Estate of Mixon, 464 F.2d at 410."	"8. The Corporation's Ability to Obtain Outside Financing"	"When there is no evidence of other outside financing, the fact that no reasonable creditor would have acted in the same manner is strong evidence that the advances were capital contributions rather than loans. Ibid. [Roth Steel, 800 F.2d at 631.]"
	"10. Presence or Absence of a Sinking Fund"	"The failure to establish a sinking fund for repayment is evidence that the advances were capital contributions rather than loans. Lane, 742 F.2d at 1317; Raymond, 511 F.2d at 191; Austin Village, 432 F.2d at 745."	"11. The Presence or Absence of a Sinking Fund to Provide Repayments"	"The failure to establish a sinking fund for repayment is evidence that the advances were capital contributions rather than loans. Ibid. [Roth Steel, 800 F.2d at 632.]"
	"11. Extent to Which the Advances Were Used to Acquire Capital Assets"	"Use of advances to meet the daily operating needs of the corporation, rather than to purchase capital assets, is indicative of bona fide indebtedness. Stinnett's Pontiac, 730 F.2d at 640; Raymond, 511 F.2d at 191; Estate of Mixon, 464 F.2d at 410."	"10. The Extent to Which Advances Were Used to Acquire Capital Assets"	"Use of advances to meet the daily operating needs of the corporation, rather than to purchase capital assets, is indicative of bona fide indebtedness. Id. [Roth Steel, 800 F.2d] at 632."

[a] 26 U.S.C. § 385(b). Identifies nonexclusive factors that Treasury regulations may include for federal tax purposes.

[b] Roth Steel Tube Co. v. Commissioner, 800 F.2d, 625, 630-32 (6th Cir. 1986) ("Roth Steel").

[c] In re AutoStyle Plastics, Inc., 269 F.3d 726, 749-53 (6th Cir. 2001) ("AutoStyle").