

§ 1.166-9 Losses of guarantors, endorsers, and indemnitors incurred, on agreements made after December 31, 1975, in taxable years beginning after such date.

(a) *Payment treated as worthless business debt.* This paragraph applies to taxpayers who, after December 31, 1975, enter into an agreement in the course of their trade or business to act as (or in a manner essentially equivalent to) a guarantor, endorser, or indemnitor of (or other secondary obligor upon) a debt obligation. Subject to the provisions of paragraphs (c), (d), and (e) of this section, a payment of principal or interest made during a taxable year beginning after December 31, 1975, by the taxpayer in discharge of part or all of the taxpayer's obligation as a guarantor, endorser, or indemnitor is treated as a business debt becoming worthless in the taxable year in which the payment is made or in the taxable year described in paragraph (e)(2) of this section. Neither section 163 (relating to interest) nor section 165 (relating to losses) shall apply with respect to such a payment.

(b) *Payment treated as worthless non-business debt.* This paragraph applies to taxpayers (other than corporations) who, after December 31, 1975, enter into a transaction for profit, but not in the course of their trade or business, to act as (or in a manner essentially equivalent to) a guarantor, endorser, or indemnitor of (or other secondary obligor upon) a debt obligation. Subject to the provisions of paragraphs (c), (d), and (e) of this section, a payment of principal or interest made during a taxable year beginning after December 31, 1975, by the taxpayer in discharge of part or all of the taxpayer's obligation as a guarantor, endorser, or indemnitor is treated as a worthless nonbusiness debt in the taxable year in which the payment is made or in the taxable year described in paragraph (e)(2) of this section. Neither section 163 nor section 165 shall apply with respect to such a payment.

(c) *Obligations issued by corporations.* No treatment as a worthless debt is allowed with respect to a payment made by the taxpayer in discharge of part or all of the taxpayer's obligation as a guarantor, endorser, or indemnitor of

an obligation issued by a corporation if, on the basis of the facts and circumstances at the time the obligation was entered into, the payment constitutes a contribution to capital by a shareholder. The rule of this paragraph (c) applies to payments whenever made (see paragraph (f) of this section).

(d) *Certain payments treated as worthless debts.* A payment in discharge of part or all of taxpayer's agreement to act as guarantor, endorser, or indemnitor of an obligation is to be treated as a worthless debt only if—

(1) The agreement was entered into in the course of the taxpayer's trade or business or a transaction for profit;

(2) There was an enforceable legal duty upon the taxpayer to make the payment (except that legal action need not have been brought against the taxpayer); and

(3) The agreement was entered into before the obligation became worthless (or partially worthless in the case of an agreement entered into in the course of the taxpayer's trade or business). See §§ 1.166-2 and 1.166-3 for rules on worthless and partially worthless debts. For purposes of this paragraph (d)(3), an agreement is considered as entered into before the obligation became worthless (or partially worthless) if there was a reasonable expectation on the part of the taxpayer at the time the agreement was entered into that the taxpayer would not be called upon to pay the debt (subject to such agreement) without full reimbursement from the issuer of the obligation.

(e) *Special rules—(1) Reasonable consideration required.* Treatment as a worthless debt of a payment made by a taxpayer in discharge of part or all of the taxpayer's agreement to act as a guarantor, endorser, or indemnitor of an obligation is allowed only if the taxpayer demonstrates that reasonable consideration was received for entering into the agreement. For purposes of this paragraph (e)(1), reasonable consideration is not limited to direct consideration in the form of cash or property. Thus, where a taxpayer can demonstrate that the agreement was given without direct consideration in the form of cash or property but in accordance with normal business practice or for a good faith business purpose,

worthless debt treatment is allowed with respect to a payment in discharge of part or all of the agreement if the conditions of this section are met. However, consideration received from a taxpayer's spouse or any individual listed in section 152(a) must be direct consideration in the form of cash or property.

(2) *Right of subrogation.* With respect to a payment made by a taxpayer in discharge of part or all of the taxpayer's agreement to act as a guarantor, endorser, or indemnitor where the agreement provides for a right of subrogation or other similar right against the issuer, treatment as a worthless debt is not allowed until the taxable year in which the right of subrogation or other similar right becomes totally worthless (or partially worthless in the case of an agreement which arose in the course of the taxpayer's trade or business).

(3) *Other applicable provisions.* Unless inconsistent with this section, other Internal Revenue laws concerning worthless debts, such as section 111 relating to the recovery of bad debts, apply to any payment which, under the provisions of this section, is treated as giving rise to a worthless debt.

(4) *Taxpayer defined.* For purposes of this section, except as otherwise provided, the term "taxpayer" means any taxpayer and includes individuals, corporations, partnerships, trusts and estates.

(f) *Effective date.* This section applies to losses incurred on agreements made after December 31, 1975, in taxable years beginning after such date. However, paragraph (c) of this section also applies to payments, regardless of the taxable year in which made, under agreements made before January 1, 1976.

[T.D. 7657, 44 FR 68465, Nov. 29, 1979, as amended by T.D. 7920, 48 FR 50712, Nov. 3, 1983]

§ 1.166-10 Reserve for guaranteed debt obligations.

(a) *Definitions.* The following provisions apply for purposes of this section and section 166(f):

(1) *Dealer in property.* A dealer in property is a person who regularly sells

property in the ordinary course of the person's trade or business.

(2) *Guaranteed debt obligation.* A guaranteed debt obligation is a legal duty of one person as a guarantor, endorser or indemnitor of a second person to pay a third person. It does not include duties based solely on moral or good public relations considerations that are not legally binding. A guaranteed debt obligation typically arises where a seller receives in payment for property or services the debt obligation of a purchaser and sells that obligation to a third party with recourse. However, a guaranteed debt obligation also may arise out of a sale in respect of which there is no direct debtor-creditor relationship between the debtor purchaser and the seller. For example, it arises where a purchaser borrows money from a third party to make payment to the seller and the seller guarantees the payment of the purchaser's debt. Generally, debt obligations which are sold without recourse do not result in any obligation of the seller as a guarantor, endorser, or indemnitor. However, there are certain without-recourse transactions which may give rise to a seller's liability as a guarantor or indemnitor. For example, such a liability may arise where a holder of a debt obligation holds money or other property of a seller which the holder may apply, without seeking permission of the seller, against any uncollectible debt obligations transferred to the holder by the seller without recourse, or where the seller is under a legal obligation to reacquire the real or tangible personal property from the holder of the debt obligation who repossessed property in satisfaction of the debt obligations.

(3) *Real or tangible personal property.* Real or tangible personal property generally does not include other forms of property, such as securities. However, if the sale of other property is related to the sale of actual real or tangible personal property, the other property will be considered to be real or tangible personal property. In order for the sale of other property to be related, it must be—

(i) Incidental to the sale of the actual real or tangible personal property; and