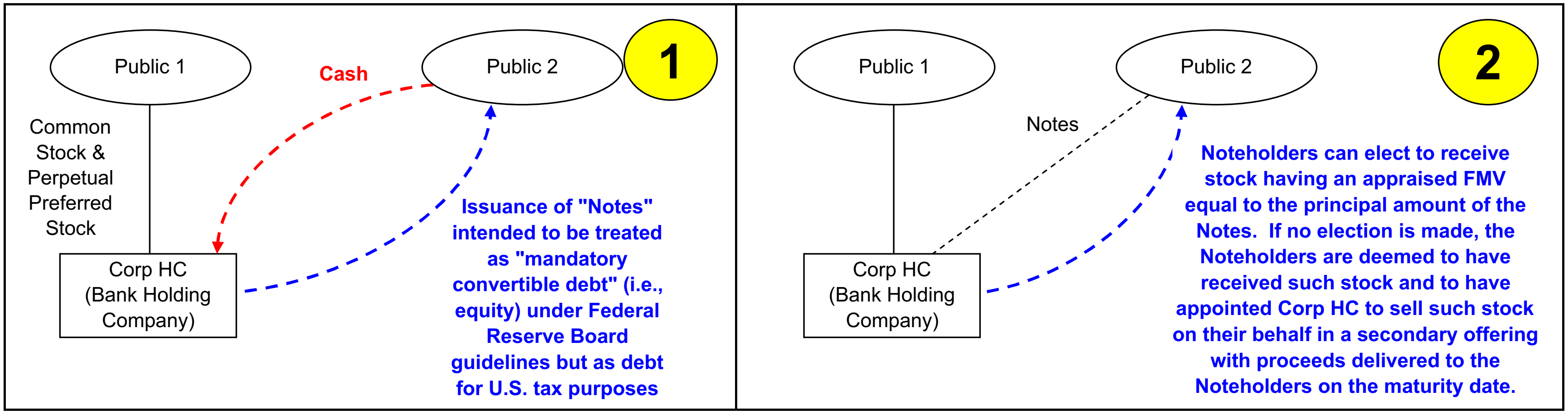
Rev. Rul. 85-119

Bank Notes: Equity for Regulatory Purposes & Debt for Tax Purposes

Issuance of Notes | **Maturity**



Corporation (HC) is a domestic bank holding company subject to regulation by the Federal Reserve Board (FRB). HC's stock is traded on a national securities exchange and is widely held. HC proposes to issue for cash $100x of instruments (Notes) described below. Under FRB guidelines, HC, as a bank holding company, must meet certain primary capital requirements. Under those guidelines, primary capital includes common and perpetual preferred stock, capital and undivided surplus, and a limited amount of "mandatory convertible debt." The guidelines further specify that a subordinated debt instrument that is issued by a bank holding company and that is payable in the issuer's common or perpetual preferred stock or redeemable with proceeds from the sale of such stock constitutes "mandatory convertible debt."

Under the terms of the Notes, amounts designated as interest are payable quarterly in cash at a floating rate comparable to the market rate on similar subordinated debt instruments payable in money at maturity and are payable without regard to HC's earnings. Regulatory and state corporate law restrictions generally applicable to the payment of dividends are not applicable to such payments. If HC defaults on its obligation to make these quarterly payments, Noteholders can sue to compel payment of the amounts then due. Notes are unsecured and subordinated to all present and future claims of general creditors of HC. Payment of principal may be accelerated only upon the bankruptcy, insolvency, or reorganization of HC. Upon the occurrence of one of these events, Noteholders are entitled to payment in money, in an amount equal to the face amount of Notes plus periodic payments that have accrued but remain unpaid, before any payments are made to shareholders.

At maturity or at an earlier redemption date, HC is unconditionally obligated to issue, in exchange for Notes, its own common or perpetual preferred stock having an appraised fair market value equal to the principal amount of Notes. The class of stock to be exchanged for Notes is left largely to the discretion of HC, and is not determined until shortly before maturity or redemption. The stock will be registered with the Securities and Exchange Commission and will be publicly traded. Upon receipt of notice of maturity or redemption, Noteholders may elect to receive this stock as payment for their Notes.

HC is not thinly capitalized. Whether the Notes constitute debt or equity, after their issuance HC will have a debt-equity ratio that is within the industry norm. The ruling held that the Notes represented debt of HC. However, see Notice 94-47.