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Client Alert

Tax

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FATCA: Implications for Structured Finance and Other Capital Markets Transactions

Introduction In 2010, Congress enacted the Foreign Account Tax Compliance Act ("FATCA") to reduce offshore tax evasion by U.S. taxpayers who hold their investments and other assets in foreign accounts. To obtain information concerning foreign accounts held by U.S. taxpayers, FATCA imposes a U.S. withholding tax on U.S. source interest, dividends, and certain other types of passive income of "foreign financial institutions" ("FFIs") and other "non-financial foreign entities" ("NFFEs") that, among other things, fail to perform certain diligence and provide information regarding their U.S. account holders and, in certain circumstances, U.S. investors. The U.S. Treasury has issued proposed FATCA regulations addressing these FATCA provisions. The Proposed regulations incorporate certain provisions set forth in prior IRS guidance, and also set forth additional provisions intended to reduce compliance burdens associated with FATCA. Under the proposed regulations, effective as of January 1, 2014, FFIs and NFFEs that do not comply with FATCA will be subject to a 30% withholding tax with respect to such U.S. source income. The proposed regulations are not final. The final regulations are expected to be issued later this year, and could differ significantly from the proposed regulations.

Recognizing the burdens associated with FATCA compliance and to facilitate coordination with local law restrictions, the U.S. Internal Revenue Service (the "IRS") is considering an alternative approach pursuant to which an FFI could satisfy its FATCA reporting requirements if (i) the FFI collects the required information and reports this information to its residence country government; and (ii) the residence country government enters into an agreement with the United States to report this information annually to the IRS. In furtherance of this approach, the IRS announced in February 2012 that it had reached an agreement with France, Germany, Italy, Spain and the United Kingdom for designing a framework to implement the information reporting and withholding provisions under FATCA.

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This Tax Alert summarizes and highlights certain aspects of FATCA and its impact on certain parties engaging in structured finance and other capital markets transactions.

Summary of Relevant FATCA Provisions

Foreign Financial Institution: An FFI is a non-U.S. entity that:

- accepts deposits in the ordinary course of banking or a similar business;
- holds financial assets for the account of others as a substantial portion of its business;
- is engaged primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities, or any interests in such securities, partnership interests or commodities; and
- certain insurance companies.

FATCA imposes a 30% withholding tax on "withholdable payments" made to an FFI, unless the FFI has entered into an "FFI agreement" with the IRS (each such FFI, a "Participating FFI") or the FFI is deemed to be FATCA compliant or is otherwise exempt from FATCA withholding. The function of the FFI agreement is to ascertain, gather and report information to the IRS regarding an FFI's U.S. account holders.

Non-financial Foreign Entity: An NFFE is any foreign entity that is not an FFI.

FATCA imposes a 30% withholding tax on "withholdable payments" made to an NFFE, unless the NFFE provides the withholding agent (generally, any person, U.S. or foreign, in whatever capacity, having control, receipt, custody, disposal or payment of a withholdable payment) with certain information regarding its "substantial U.S. owners" (i.e., U.S. persons owning directly or indirectly more than 10% of the NFFE's equity interests) or certifies that it has no substantial U.S. owners or establishes that it is otherwise exempt from FATCA withholding.

Withholdable Payments: Withholdable payments generally include:

- U.S. source payments of interest, dividends and other fixed or determinable annual or periodical income ("FDAP Income");
- the gross proceeds from the sale of property that produces U.S. source interest and dividends (i.e., shares of stocks and bonds issued by U.S. companies).

The proposed regulations set forth exceptions for certain payments that may otherwise be treated as a withholdable payment, including FDAP income and gross proceeds that are effectively connected with the conduct of a U.S. trade or business.

Grandfathered Obligations: Under current law, FATCA generally does not apply to payments under any obligation outstanding as of March 18, 2012, or from the gross proceeds from the disposition of such obligation. However, the proposed regulations extend this date to any obligation outstanding as of January 1, 2013.

Effective Date: Although FATCA technically is effective as of January 1, 2013, the proposed regulations provide that withholding on FDAP Income is delayed until

January 1, 2014, and withholding on gross proceeds is delayed until January 1, 2015. Exhibit A sets forth a more detailed description of the timelines and effective dates applicable to various FATCA-related matters under the proposed regulations.

Certain FATCA Considerations for Structured Finance and Other Capital Markets Transactions The enactment of FATCA and the recent release of proposed FATCA regulations have caused significant inquiries and concern for parties engaged in structured finance and other capital market transactions. Specifically, banks, investors and other participants in such transactions are concerned about the impact of FATCA on such transactions, and the requirements necessary to be FATCA-compliant. Moreover, the application of FATCA to a participant in connection with a particular transaction generally will also depend upon such participant's role in the transaction. Set forth below is a general summary of the FATCA issues that may arise in connection with structured finance and other capital market transactions, as well as certain FATCA considerations relevant to custodians, issuing and paying agents, and administrators.

FATCA Considerations Generally: Parties to structured finance and other capital market transactions should be mindful of the FATCA-related considerations that may arise as a result of such transactions, including:

- whether a participant in the transaction is an FFI, NFFE or a withholding agent;
- whether the transaction will give rise to any withholdable payment;
- whether a participant's role in connection with a particular transaction gives rise to any obligations under FATCA;
- whether a participant has established systems and procedures to ensure FATCA compliance; and
- whether a participant may be exempt from FATCA withholding (although this is unlikely for most participants in structured finance and other capital market transactions);
- where a participant is an FFI, whether there are any local law restrictions (e.g., confidentiality) that would prevent the FFI from complying with its obligations under an FFI agreement.

Which Participants Are FFIs?: As noted above, FFIs include those institutions that hold financial assets for the account of others as a substantial portion of their business. Thus, FFIs potentially subject to FATCA withholding include foreign banks, custodial banks, broker-dealers, trust companies, and entities acting as custodians with respect to financial assets.

In this regard, it is worth noting that, while a participant in a structured finance or other capital markets transaction may be considered an FFI, it does not necessarily follow that such participant's role in such transaction results in obligations under FATCA. For example, a foreign bank acting solely as an administrator in connection with a transaction may not have any FACTA obligations as a result of such transaction even though the foreign bank generally would be treated as an FFI.

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FATCA Considerations for Custodians: Custodians in structured finance transaction generally act either (i) as part of a stand-alone bilateral or tri-party custody agreement holding cash and/or securities on behalf of the security provider; or (2) as a part of a programme or stand-alone structured finance transaction holding cash and/or securities on behalf of an issuer.

Accordingly, custodians, as holders of financial assets for the account of others, generally will be treated as FFIs (unless otherwise exempt). As a result, in order to avoid FATCA withholding on any withholdable payment it receives in connection with the transaction, a custodian would need to enter into an FFI agreement with the IRS, and establish procedures to comply with its obligations under such agreement. Such obligations include:

- performing diligence on its "financial accounts" (including custodian accounts);
- identifying which financial accounts are held by U.S. persons or foreign entities with substantial U.S. owners;
- reporting certain information to the IRS each year about its U.S. account holders and "recalcitrant account holders" (i.e., those that fail to provide requested information to determine such holder's status);
- adopting written policies and procedures governing FATCA compliance, conducting periodic compliance reviews and periodically certifying such compliance to the IRS;
- withholding 30% on certain "pass-thru payments" (i.e., withholdable payments to recalcitrant account holders and account holders that are non-Participating FFIs ("U.S. pass-thru payments"), and foreign source payments made to such account holders that are attributable to withholdable payments received by the custodian ("foreign pass-thru payments")); and
- where any foreign law would otherwise prevent the reporting of any information required under the FFI agreement with respect to its U.S. accounts, either (i) to attempt to obtain a valid and effective waiver of such law from each holder of a U.S. account and (ii) if such a waiver is not obtained from a U.S. account holder within a reasonable period of time, to close such account.

The proposed regulations provide that debt and equity issued by an FFI that is a bank, broker, or custodian generally will not be treated as a "financial account." This rule, however, is subject to certain exceptions, including an exception for issuances by an FFI of an instrument the value of which is determined by reference to U.S. assets (i.e., certain structured notes). Thus, in general, foreign banks will not need to treat holders of their privately placed conventional debt as holding "financial accounts" for FATCA purposes. Consequently, the FATCA due diligence requirements would not apply to such debt and equity that is not treated as a financial account.

FATCA Considerations for Issuing and Paying Agents: In general, issuing and paying agents, acting on the instructions of the sponsoring entity, effect the issuance of debt instruments to investors and arrange for payments to such investors.

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Because issuing and paying agents, acting in such capacity, have control, receipt, custody and disposal of payments under a debt instrument, they generally will be considered withholding agents with respect to any withholdable payments. Accordingly, issuing and paying agents generally would be required to withhold 30% on any such withholdable payments made to non-Participating FFIs and to NFFEs that fail to certify that they do not have any substantial U.S. account holders or, alternatively, do not provide information regarding their substantial U.S. account holders.

FATCA Considerations for Administrators: In general, administrators provide various services in connection with structured finance and capital markets transaction, including day-to-day management and assistance

hedging, calculating shortfalls, arranging for payments (through paying agents), and effecting transactions on behalf of the issuing entity to enter into various forms of liquidity enhancing facilities and/or hedging transactions.

Although an administrator may be an FFI (or withholding agent) due to activities separate and apart from its activities as an administrator, it would not appear that the administrator's activities as such generally would give rise to FATCA obligations. However, if, in connection with its participation in a particular structured finance or other capital markets transaction, such party either (i) has control of any payments that are withholdable payments or (ii) will receive a payment that is a withholdable payment, FATCA obligations generally would arise.

This *Tax Alert* is intended only to provide a general summary of certain FATCA provisions, and does not address all potential issues that may affect withholding agents, FFIs, NFFEs or other persons under FATCA. If you have any specific questions, or would like additional information about the provisions discussed above, please contact one of the authors or the Reed Smith attorney with whom you regularly work.

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To ensure compliance with U.S. Treasury Department regulations, we inform you that any federal tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the United States Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

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EXHIBIT A FATCA-RELATED TIMELINES & EFFECTIVE DATES UNDER PROPOSED FATCA REGULATIONS		
DESCRIPTION	**DATE**	**COMMENT**
Final FATCA Regulations expected	End of 3rd Quarter of 2012	
Date IRS begins accepting applications for FFI Agreements.	January 1, 2013	See Notice 2011-53. 2011-32 IRB 124.
Date obligation must be outstanding for grandfather provision to apply	January 1, 2013	Under current law, the grandfather provision apples to obligations outstanding as of March 18, 2012.
Date withholding agents begin withholding on FDAP Income paid to non-Participating FFIs	January 1, 2014	
Date Participating FFIs must begin withholding on U.S. pass-thru payments	January 1, 2014	
Date withholding agents begin withholding on gross proceeds paid to non-Participating FFIs	January 1, 2015	
Date Participating FFIs must begin withholding on foreign pass-thru payments	January 1, 2017	Participating FFIs generally will be required to report (but not withhold) on foreign pass-thru payments made to non-Participating FFIs during 2015 and 2106.
Date Participating FFIs are required to report information to the IRS about its U.S. account holders and recalcitrant account holders during a calendar year	March 31st of the following calendar year	FATCA report for the 2013 calendar year due September 30, 2014 for U.S. account holders and recalcitrant account holders as of June 30, 2014. The IRS is reducing the amount of information to be reported for calendar years 2013, 2014 and 2015. Full reporting will begin in 2017 for calendar year 2016.

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