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CLIENT UPDATE

LSTA PUBLISHES NEW MODEL CREDIT AGREEMENT TAX PROVISIONS

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To Our Clients and Friends:

On August 10, 2011, the Loan Syndications and Trading Association (the "LSTA") released a new version of its Model Credit Agreement Provisions (the "LSTA Model"). The LSTA Model includes various provisions relating to taxes.

The LSTA is a trade group that represents participants in the floating rate corporate loan market and publishes model terms for credit agreements. While the LSTA describes its model terms as reflecting market practice, borrowers should be aware that the LSTA Model is principally drafted by representatives of lender organizations and that the model language is generally favorable to the interests of lenders. There is a range in market practice, and borrowers should carefully scrutinize the tax provisions of any proposed credit agreement furnished by lenders' counsel that is based on the LSTA Model.

We note the following tax provisions in the LSTA Model that are particularly favorable to lenders and that are frequently resisted by borrowers:

- The LSTA Model generally requires borrowers to gross up or indemnify lenders for a wide variety of taxes that might be imposed on payments made to lenders. Whereas middle-of-the-road terms would provide an exclusion for any such taxes imposed as a result of a connection (independent of the credit agreement) between the applicable lender and the jurisdiction imposing the tax, the LSTA Model limits this connection-based exclusion to net income, franchise and branch profits taxes. Borrowers may, therefore, be required to indemnify lenders for connection-based taxes outside this exclusion, such as taxes on gross income and gross receipts, even if imposed under current law.
- The LSTA Model generally requires borrowers to indemnify lenders if certain changes in law increase the cost to lenders of maintaining a loan. The extent to which this increased cost indemnity applies to taxes is a matter of negotiation, but borrowers often seek to exclude all taxes from this indemnification, or at least a set of taxes that is broader than those excluded in the LSTA Model (including so-called "bank taxes").

- The LSTA Model generally provides that a participant of a lender is entitled to protection under the tax and increased costs provisions, but that a participant may not receive any greater payment than its participating lender would have been entitled to receive in the absence of the participation. The LSTA Model provides an exception to this "no greater than" provision to the extent the increased payment results from a change in law occurring after the participant acquired its interest in the loan. Borrowers frequently resist this "change in law" exception, as borrowers usually have no ability to control a lender's sale of participations and have no visibility into who the participants are.

- The LSTA Model generally provides that the borrower's responsibility for U.S. withholding tax does not apply to taxes in effect on the date on which the lender acquires its interest in the loan or commitment. In the case of a partner of a lender that is treated as a non-U.S. partnership for U.S. tax purposes, however, the LSTA Model makes the borrower responsible for such taxes if imposed pursuant to a law that becomes effective after the date the lender acquires its interest in the loan but before the date the partner in the lender acquires its interest in the lender. Borrowers that wish to avoid this result may negotiate for changes of law to be measured, in the case of a lender that is a non-U.S. partnership, from the later of the date the lender acquires its interest in the loan or commitment and the date the relevant partner in the lender acquires its interest in the lender.

- The LSTA Model is ambiguous as to whether a borrower is obligated to indemnify a lender that is a U.S. partnership for U.S. withholding tax imposed with respect to a non-U.S. partner's indirect interest in a loan, a result that would be contrary to the expectations of many borrowers.

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Please feel free to contact us with any questions.

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