

## ISDA PUBLISHES PROPOSED LANGUAGE ON FATCA WITHHOLDING

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To Our Clients and Friends:

The Foreign Account Tax Compliance Act (“FATCA”) provisions of the 2010 Hiring Incentives to Restore Employment Act impose a new 30% withholding tax regime on a broad variety of U.S.-source payments and payments of gross proceeds from the sale or other disposition of property that can produce U.S.-source interest or dividends (“withholdable payments”) made to foreign entities, subject to certain exceptions. In general, payments to foreign entities that are banks, other financial intermediaries or investment funds (“FFIs”) will be subject to the new withholding tax unless the FFI agrees with the IRS to comply with certain reporting and withholding requirements. Payments to other foreign entities (“NFFEs”) generally will be subject to the new withholding tax unless the NFFE complies with certification requirements regarding certain of its U.S. owners.

The new withholding tax is also imposed on “passthru payments” (which includes withholdable payments as well as payments—even if not U.S.-source income—that are “attributable” to withholdable payments) made by an FFI that agrees with the IRS to comply with the FATCA reporting and withholding requirements noted above (a “participating FFI”) to (i) account holders that do not provide certain information requested by the FFI or (ii) FFIs that are not participating FFIs. Based on preliminary IRS guidance, non-custodial payments (possibly including payments under a swap or other derivatives transaction) made by a participating FFI can be passthru payments subject to withholding based on the percentage of such FFI’s worldwide assets that consist of “U.S. assets,” even if the payments and the underlying transaction have no direct connection with the United States.

The statute provides that fixed-term obligations (excluding equity and potentially excluding collateral arrangements without a fixed maturity, such as under a typical Credit Support Annex) outstanding on March 18, 2012, are not subject to the new withholding tax. As the IRS has not extended this “grandfathering” date, obligations issued (or substantially modified) after March 18, 2012, may be subject to FATCA withholding. The IRS has, however, generally delayed the start date for FATCA withholding to January 1, 2014 (January 1, 2015, for certain categories of payments, including passthru payments).

In light of the above, the International Swaps and Derivatives Association, Inc. (“ISDA”), has proposed the following language addressing FATCA for market participants to consider incorporating into their derivatives documentation:

Foreign Account Tax Compliance Act. (a) For purposes of any Payer Tax Representation, the words “any tax from any payment” shall not include any tax imposed under Sections 1471 and 1472 of the Internal Revenue Code of 1986, as amended, (or the United States Treasury Regulations or other guidance issued thereunder) (“FATCA Withholding Tax”); and (b) the definition of “Indemnifiable Tax” shall not include any FATCA Withholding Tax.

This language places the burden of FATCA withholding on the recipient of a payment. This language, and the underlying FATCA issues, may be relevant to a party to a derivatives transaction as payor, payee or both.

ISDA has also suggested that market participants consider whether other FATCA-related provisions should be included in their derivatives documentation, such as:

- a representation from a non-U.S. counterparty regarding its status for FATCA purposes (*e.g.*, participating FFI, NFFE, etc.);
- a certification from an NFFE as to its “substantial U.S. owners”;
- a representation from a participating or deemed-compliant FFI regarding compliance with, and a covenant to comply with, the applicable FATCA requirements with respect to it and certain of its affiliates;
- a covenant by a non-U.S. party to deliver the forms or other documentation prescribed by the IRS for FATCA purposes; and
- a specific termination right by the burdened party upon the imposition of FATCA withholding tax.

The FATCA rules are complex, and the guidance issued to date by the IRS leaves many questions unanswered. While it is expected that additional IRS guidance will be issued shortly, in the meantime parties that have entered or will enter into any derivatives transaction should review the related documentation in light of the FATCA rules.

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Please do not hesitate to contact us if you have any questions.

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