CLIFFORD CHANCE

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FATCA – USA imposes new global withholding and information obligations for Non-American financial institutions

The United States has enacted legislation (commonly referred to as "FATCA") that, starting in 2013, will impose new information reporting and withholding requirements with respect to certain holders of "financial accounts" with non-US financial institutions. Under FATCA, non-US financial institutions generally must enter into agreements with the US Internal Revenue Service (the "IRS") to identify financial accounts held by US persons or entities with substantial US ownership, and accounts held by other financial institutions that are not themselves participating in (or otherwise exempt from) the FATCA reporting regime. For these purposes, financial institutions include deposit-taking institutions, persons holding financial assets for the accounts of others, and persons engaged primarily in the business of investing or trading in financial assets or derivatives. If a financial institution does not enter into an IRS agreement (and is not otherwise exempt), FATCA imposes a new 30% US withholding tax on all payments of passive-type income that the financial institution receives from US assets, and on certain payments coming indirectly from US assets as described below.

Under the IRS agreement, a participating financial institution must withhold 30% of certain payments it makes to a US accountholder that has not cooperated in the reporting of its account, or to a non-US financial institution without an IRS agreement (and that is not otherwise exempt). The US Treasury Department intends to issue regulations that will treat, for example, interest and principal paid by a participating financial institution as being subject to 30% withholding, but only in proportion to the value of the financial institution's US assets (including US assets held indirectly through other participating financial institutions) as compared to its total assets. The withholding will not, however, apply to debt obligations issued on or before March 18, 2012, and not modified significantly after that date.

Under FATCA, a tax treaty will not prevent the withholding of tax. If the withheld tax exceeds the amount of US tax permitted under a tax treaty, the payee can obtain a refund by filing a tax return. However, the payee will not receive interest on the over-withheld tax.

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Accordingly, if a non-US financial institution that has an agreement with the IRS receives a loan from another non-US financial institution after March 18, 2012 (including a draw on a revolving facility concluded before that date), a portion of the principal and interest payments made on such loan after December 31, 2012 will be subject to 30% US withholding unless the payee establishes that it also has an agreement with the IRS, or is otherwise exempt from the FATCA reporting and withholding regime.

The market has not yet developed standards for allocating the FATCA risk on loans between non-US financial institutions. However, a standard has developed for syndicated loans to US borrowers under which the lenders assume all risk of FATCA withholding. In the case of loans between non-US institutions there are competing arguments for allocating the risk to the lender or to the borrower. The main arguments for allocating the risk to the lender are (i) the tax has been enacted so there is no change in law; (ii) the lender controls whether it signs an IRS agreement; and (iii) many lenders intend to sign IRS agreements and lenders who choose not to sign IRS agreements will be replaced by those who do.

The main arguments for allocating the risk to the borrowers are (x) the loan has no US connection other than the borrower's own direct or indirect US asset holdings; (y) the tax is not mandatory but instead results from the borrower's voluntary agreement with the IRS; and (z) there are large uncertainties regarding the costs and consequences of an IRS agreement that a lender cannot accept as a condition to making the loan.

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