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Tax Extenders Act of 2009 Includes Updated FATCA Tax on Withholdable Payments and Revised Ban on Bearer Bonds

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On December 7, 2009, U.S. House Ways and Means Committee Chairman Charles B. Rangel (D-New York) introduced H.R. 4213, the Tax Extenders Act of 2009 (the "Bill"). As its name suggests, the Bill is aimed at extending certain tax provisions set to expire at the end of the year. Importantly, the Bill also includes, with certain modifications, the Foreign Account Tax Compliance Act of 2009 ("FATCA"), which was introduced at the end of October 2009 in the U.S. House and Senate.[1] The FATCA provisions introducing a new 30% withholding tax on withholdable payments made to foreign financial institutions that fail to comply with specified reporting requirements, and FATCA's proposed repeal of the U.S. bearer bond exception, had significant ripple effects in the global capital markets. We summarize below the Bill's amendments to those provisions, many of which are intended to address issues in the original FATCA provisions raised by market participants.

Tax on Withholdable Payments

The Bill includes a number of changes with respect to FATCA's proposed 30% U.S. withholding tax on "withholdable payments" made to a foreign financial institution ("FFI") (whether or not beneficially owned by such institution) unless the FFI signs an information sharing agreement with the U.S. Treasury Department ("Treasury"). Particularly noteworthy are the following:

Effective Date. The effective date of provisions imposing the new tax has been amended. The tax is now proposed to apply to payments made after December 31, 2012 (rather than December 31, 2010).

Grandfather Provision. The grandfather provision has been amended. As proposed in the Bill, the tax would not apply to payments made on debt obligations outstanding on the date which is two years after enactment of the Bill. The grandfather provision no longer requires the terms of a debt obligation that is registered (for tax purposes) to include a gross-up provision that would be triggered as a result of enactment of the Bill. All debt obligations now would be eligible for the grandfather.

FFI Election to Be Withheld On. Rather than agreeing with Treasury to act as a withholding agent in respect of reportable payments, pursuant to a new provision of the Bill, an FFI may elect to provide the withholding agents from which it receives payments with the information necessary for the withholding agents to implement the new withholding tax (generally, information that discloses the extent to which payments made to the electing FFI are allocable to accounts subject to the 30% U.S. withholding tax). In addition, the agreement entered into between the electing FFI and Treasury must include a waiver of any right under any tax treaty of the United States with respect to any amounts withheld under this new election provision.

New Provision for FFIs with No U.S. Accounts. The Bill contains a provision pursuant to which an FFI may be treated as meeting the specified reporting requirements of the Bill if (i) it complies with procedures ensuring it maintains no U.S. accounts and meets certain requirements with respect to other FFIs maintaining an account with it, or (ii) such FFI is a member of a class of institutions which would not be subject to these provisions. Implementing procedures, requirements, and determinations in respect of this provision would be determined by Treasury in future guidance.

Repeal of Bearer Bond Exception

The Bill amends the proposed FATCA provisions repealing the U.S. bearer bond exception as follows:

Effective Date. As proposed under FATCA, the Bill would still effectively require that debt issued by a U.S. issuer be issued in registered form. However, the effective date of these provisions has been amended. Under the Bill, the repeal of the bearer bond exception would apply to debt obligations issued after the date which is two years after the enactment of the Bill.

Expansion of Portfolio Interest Exception for Registered Debt. The Bill includes a provision giving Treasury the authority to determine that certification (required under current law) as to non-U.S. beneficial ownership (e.g., Form W-8BEN) is not required to qualify for the portfolio interest exemption from withholding tax on payments of interest on certain registered debt obligations.

Dematerialized Book Entry Systems Treated as Being in Registered Form. The Bill proposes to codify Internal Revenue Service Notice 2006-99. Accordingly, debt obligations cleared through dematerialized book entry systems (such as JASDEC in Japan) would be treated as being issued in registered form. U.S. issuers using such a system would be required to comply with the certification provisions applicable to registered debt (e.g., Form W-8s) in order to tap the portfolio interest exception for their debt issuances.

TEFRA Exception for Excise Tax Preserved. Under current law, the excise tax imposed on issuers of bearer bonds (equal to 1% of the principal amount times the number of years to maturity) does not apply if the bonds are issued under TEFRA-compliant procedures.[2] Unlike the original FATCA, the Bill preserves this exception. As a result, a foreign issuer of a “foreign-to-foreign” bearer debt offering that is TEFRA-compliant would not be subject to the excise tax.

Prospects for the Bill

The Bill is expected to come up for a vote in the U.S. House of Representatives on December 9, 2009. Assuming a favorable vote, the Bill will then shift to the U.S. Senate. Recent news reports indicate that while Senate Finance Committee Chairman Max Baucus is focused on passing the Bill this year, final action very well could slip into 2010.

Footnotes

[1] Please see our series of three client alerts addressing FATCA’s provisions:
http://www.mofo.com/news/updates/files/16103.html,
http://www.mofo.com/news/updates/files/16106.html, and
http://www.mofo.com/news/updates/files/16113.html.

[2] "TEFRA" is the Tax Equity and Fiscal Responsibility Act of 1982; it effectively banned bearer bonds except those issued under "arrangements reasonably designed to ensure sale to non-U.S. persons."
