FATCA Repapering

FBF

22 avril 2013
1. Context
Questions have been raised on the French market to know whether or not FATCA clauses should be included in existing contracts (or new contracts under negotiation) which are generally in the CIB industry based on the ISDA Master Agreement (International Swaps and Derivatives Association) and the GMRA (Global Master Repurchase Agreement).

► Basically, FATCA withholding tax applies to payments realized by an FFI/USFI to a non-FATCA compliant counterparty. Accordingly, if all the counterparties are FATCA compliant (reporting IGA partner country, PFFI, USFI or compliant NFFE), a FFI/USFI payer will not need to gross up for FATCA tax, even in the absence of FATCA language in the related contract.

► However, if one counterparty is not FATCA compliant or ceases to be FATCA compliant, a FFI/USFI payer will need to gross up for FATCA tax, which represents a risk for the payer or the beneficiary, depending on the provisions of the related contract and their interpretation.

► The risk therefore exists for trades that cannot benefit from the grandfathering clause, concluded after December 31, 2013 (dates from which FATCA withholding on FDAP will apply) with a counterparty that is not FATCA compliant if FATCA language is not contained in the agreement.

► The risk also concerns collaterals that cannot benefit from the grandfathering clause and that generates US source payments to a non FATCA compliant counterparty where FATCA language is not contained in the agreement.

At the level of the international organization, ISDA published on November 2011 a first proposed language to incorporate into existing or future ISDA Master Agreement and to address the effects of FATCA withholding tax on derivatives transactions. This proposed language was replaced by a new one on 15 August 2012: “The FATCA Protocol”. To be noted that no FATCA language that may apply to GMRA has been proposed.

This presentation concerns impact of FATCA in terms of repapering CIB contracts / FATCA withholding impact on products. However, please bear in mind that from a legal perspective, FATCA triggers other issues:

- Identification of limited FFIs and branches depends on local legal analysis, legal / commercial considerations raised by filing with US / local tax administration information on account holders or their US shareholders.
- Other contracts / documentation to repaper (e.g., account agreement and retail customer relationship management, prospectus of funds, general terms and conditions of services of brokers).
### Withholding in a Final Regulations environment

#### Calendar

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Proceeds</th>
<th>Passthru Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td></td>
<td></td>
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<tr>
<td>2015</td>
<td></td>
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<tr>
<td>2016</td>
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<tr>
<td>2017</td>
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</tbody>
</table>

#### Payments

- **U.S. Source FDAP**
  - January 1st, 2014: **U.S. FDAP Payment to Prima Facie FFIs**
  - January 1st, 2015: **U.S. FDAP Payment to Passive NFFEs**
  - January 1st, 2016: **US FDAP Payment to NPFFIs**
  - January 1st, 2017: Gross Proceeds and Passthru Payments

#### Deadline for withholding
- January 1st, 2014
- July 1st, 2014
- January 1st, 2015
- January 1st, 2016
- January 1st, 2017

#### Payees (entities)

- **Preexisting**
  - **New**

#### Grandfathering clause

- Grandfathered obligation cut-off

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*An IRS official stated in a public conference held on February 6, 2013 that the effective date for this provision will be moved to 1Jan 2016

**Specific rules for transactions which would enter in section 871(m) and subject to passthru payments**
2. On what?

Withholdable Payments

- **US FDAP income**
- **Gross proceeds** from the sale of any property producing interest or dividend
- **Exclusion of income from transfer of securities for which gain or loss is excluded from recognition**
- **Application to property of a type that gives rise to the payment of interest or dividends that would constitute US FDAP including contracts producing dividend equivalent payments**
- **Inclusion of interest paid by foreign branches of U.S. FI**
- **Temporary exclusion** from the U.S. source FDAP income of payments with respect to an offshore obligation made prior to January 1, 2017 by a person that is not acting as an intermediary (a Qualified Securities Lender is considered as an intermediary for this purposes)

- **As from 01/01/2014**
- **As from 01/01/2017**
- **Not before 01/01/2017**

Foreign Passthru Payments

- **No definition of Foreign Passthru Payment (reserved)**

**Except if grandfathered clause applies**
### Products analysis

**FATCA withholding risk without any timing consideration**

<table>
<thead>
<tr>
<th></th>
<th>IGA (QI2)</th>
<th>Final Reg</th>
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</thead>
<tbody>
<tr>
<td><strong>Derivatives</strong></td>
<td></td>
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</tr>
<tr>
<td>▶ Non US equity swaps (e.g. interest swaps, Fx swaps)</td>
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<td>green</td>
</tr>
<tr>
<td>▶ US equity swaps</td>
<td>green</td>
<td>red</td>
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<tr>
<td>▶ Future, Forward, Option with US security underlying</td>
<td>green</td>
<td>orange</td>
</tr>
<tr>
<td>▶ Future, Forward, Option with non non-US security underlying</td>
<td>green</td>
<td>green</td>
</tr>
<tr>
<td><strong>Syndicated loans (US Borrower)</strong></td>
<td>red</td>
<td>red</td>
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<tr>
<td><strong>Stock lending / REPO</strong></td>
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<tr>
<td>▶ On non US securities</td>
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<td>green</td>
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<tr>
<td>▶ On US securities</td>
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<tr>
<td><strong>Collateral</strong></td>
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<tr>
<td>▶ US securities</td>
<td>red</td>
<td>red</td>
</tr>
<tr>
<td>▶ Non US securities</td>
<td>green</td>
<td>green</td>
</tr>
</tbody>
</table>
2. Practical impact in terms of repapering
FATCA creates serious financial risk

**Non-Compliance Risk**

FFIs that do not enter into a FATCA Agreement with Treasury by December 31, 2013 and are not located in a country that has entered into an intergovernmental agreement with the US (each an “IGA Country”) are likely to bear FATCA withholding tax on a variety of payments, potentially including, after December 31, 2016, payments on “wholly foreign” transactions.

**Absence of FATCA Language Risk**

Participating FFIs and USFIs that do not modify their Master Agreements to address FATCA for transactions with NPFFI counterparties are at risk for grossing up a counterparty for FATCA withholding tax on certain gross amounts payable.

Note: FATCA tax is due on the gross amount payable to a counterparty, not the net payment.

**December 31, 2013 Risk**

Certain trades entered into or materially modified post December 31, 2013 will not qualify for grandfathering relief, so payments made after December 31, 2013 on such trades are potentially subject to FATCA withholding.
Repapering prioritisation

- **IGA**
  - **Localization of payer (self)**
    - **Contract where payer is at risk**
      - Derivatives with US security underlying if QI1
      - Repo / Security lending over US security*
      - Syndicated loan
      - Collateral
    - **Contract where payer is at risk or risk postponed**
      - Grandfathered obligation
      - Derivatives if QI2 or NQI
      - Gross Proceed
      - Foreign Passthru Payment
    - **Contract where payer is at risk or risk postponed**
      - No grandfathered obligation
      - Agreement initially grandfathered but subject to material modification
      - No temporary withholding exception
      - Repo / Security lending over US security* (acting as intermediary)
  - **Final Regulations**
    - **Contract where payer is at risk**
      - Grandfathered obligation
      - Derivatives with non-US security underlying
      - Temporary withholding exception
      - Gross Proceed
      - Foreign Passthru Payment
    - **Contract where payer is at risk or risk postponed**
      - Derivative with US security underlying* (issued as principal)
      - Repo / Security lending over US security* (acting as principal)
      - Collateral
      - Syndicated loans
    - **Contract where payer is at risk or risk postponed**
      - Derivative with US security underlying* (acting as principal)
      - Repo / Security lending over US security* (acting as intermediary)

* Already at risk under Section 871(m)
Example of FATCA related considerations for contracts modification

- Determination of the person bearing the burden of FATCA withholding
- Document delivery language for any documents required for FATCA purposes
- Termination rights for either or both parties if FATCA withholding may apply
- Representations that there are no US persons that have more than a 10% (or 25% in an IGA environment) beneficial interest (or a "controlling" interest) in a party to the Master Agreement
- Representations as to FATCA compliance where one party is required by rating agency considerations to gross up the other party for all taxes
- Mutual agreement that neither party will delegate withholding responsibility under 1471(b)(3) of the Code to the other
- Rendez-vous language

When and how to repaper?

### Approach for existing contracts
- Open renegotiation for contracts triggering FATCA issues as from 2014 and grandfathered agreements that are subject to material modification after 2014
- It may be dangerous to open renegotiation just to insert a FATCA rendez-vous language

### Approach for new contracts
- Insert a FATCA language if the contract is at risk at the date of the conclusion
- Insert a FATCA rendez-vous language if the contract is not at risk at the date of the conclusion but may be later.
Challenges of the negotiation

- **Stakes in case of negotiation between a PFFI counterparty and a NPFFI counterparty (e.g. banks vs. funds); a gross-up payment may be required by the NPFFI but refused by the PFFI**
  
  It seems reasonable to place the FATCA withholding tax burden on the recipient of the payment. The rationale is that the recipient is the sole party that has the ability to avoid the withholding tax by complying with the FATCA rules; therefore, the recipient should be the party burdened with the FATCA withholding tax if it chooses to not comply.

- **Stakes in case of negotiation with a counterparty which is not very familiar with FATCA rules**
  
  This approach is the one retained by the ISDA North American Tax Committee and more generally by the market (an ISDA FATCA Provision was developed in order to allow market participants to incorporate such provision, into their existing or future ISDA Master Agreements).

- **Issue linked to the negotiation per se of existing agreements**

- **Issue linked to the obtention of a W8 BEN for identification purposes**
3. Appendix
Preliminary FATCA Timeline

**FFI Compliance**
- **Registration Portal Open**: Pre-existing accounts due diligence.
- **FFI Agreement Effective Date**: New accounts due diligence.

**New Account Onboarding**
- **Grandfathered Obligation**: No due diligence required.
- **Participating FFI Reporting**: Due diligence for high value (HV) individual accounts.

**Pre-Existing Account Due Diligence**
- **Pre-Existing Account Due Diligence**: Complete due diligence for all remaining accounts.

**Withholding**
- **US Withholding Agent (USWA) Milestone**: Responsible Officer makes certifications related to due diligence and FATCA anti-avoidance.
- **PFFI Milestone**: USWA and PFFI begin withholding on US FDAP payments.

**Reporting**
- **Participating FFI Reporting on Pre-Existing Accounts and on Non-FFI Accounts**: Reporting for US accounts includes gross proceeds for YE 2013 and YE 2014.
- **Participating FFI Reporting on Owner Documented FFIs and NFFEs with Substantial US Owners**: Reporting for US accounts includes gross proceeds for YE 2013 and YE 2014.

This timeline does not reflect the deadlines related to entities that are affected by an Intergovernmental agreement. Dates used for PFFIs assume the FFI agreement has the earliest possible effective date of December 31, 2013.

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