

Tax Extenders Act of 2009

December 9, 2009 Today, the House of Representatives passed the “Tax Extenders Act of 2009” (“TEA”). If passed by the Senate, the bill would extend a number of tax relief provisions through 2010 (including the research and development tax credit, the new markets tax credit, the active financing exception from subpart F income for controlled foreign corporations, and the exemption from U.S. withholding tax for foreigners that invest in certain fixed-income mutual funds).

The bill also reintroduces the Foreign Account Tax Compliance Act of 2009 (“FATCA”; H.R. 3933 and S. 1934) (briefly described [here](#)) with certain helpful amendments.

Finally, the bill would tax income and gain from carried interests in certain partnerships as ordinary income. The carried interest proposal is identical to the proposal that was introduced in prior bills (H.R. 3996 and H.R. 6275); it is limited to carried interests in certain investment fund managers and is not as broad as the Obama Administration’s proposal (which would apply to carried interests in any partnership) (briefly described [here](#)).

The balance of this e-mail summarizes the differences between FATCA and the corresponding provisions of TEA.

Foreign Account Reporting

- **In General.** Both FATCA and TEA generally require “foreign financial institutions” (which is defined broadly to include most foreign hedge funds, private equity funds, and securitization vehicles) to determine which of its equity and debt holders (and certain other of its counterparties and other “account holders”) are United States persons and to report this information to the IRS or otherwise be subject to a 30% withholding tax on its U.S.-source income and the proceeds of certain sales and other dispositions. Certain foreign non-financial institutions are subject to similar requirements, but only with respect to 10% U.S. equity holders.
- **Effective Date.** FATCA was proposed to be effective for payments made after December 31, 2010 and provided a grandfather provision for obligations outstanding on the date of the first committee action that were either in bearer form or obligated their issuer to provide a gross-up by reason of the proposed withholding requirements. TEA would be effective for payments made after December 31, 2012. Moreover, TEA does not apply to any payment made under any

“obligation” that is outstanding two years after the date of enactment. It is unclear whether the term “obligation” is limited to debt obligations or applies to a broader class of financial instruments.

- **“Recalcitrant Account Holders.”** Under FATCA, if a foreign financial institution was unable to obtain information about any of its United States debt, equity or other account holders, it was potentially subject to a 30% withholding tax on 100% of its U.S.-source payments. Under TEA, if a foreign financial institution is unable to obtain the information from a particular account holder (referred to as a “recalcitrant account holder”), the foreign financial institution may either (i) withhold 30% from the payments it makes to the recalcitrant account holder or (ii) elect to receive its U.S.-source payments subject to 30% withholding on the portion that is allocable to the recalcitrant account holder.
- **Exemption Where Reporting Would Be Duplicative.** FATCA required that foreign financial institutions obtain information about its equity and debt holders, even if the equity and debt securities are held through the Depository Trust Corporation (“DTC”). TEA provides that a foreign financial institution need not report any U.S. account holder if the account is held by another foreign financial institution that itself satisfies the reporting requirements under TEA, or if the account holder is otherwise subject to information reporting that Treasury determines would make reporting by the foreign financial institution duplicative. Although it is not entirely clear, this provision may exempt foreign financial institutions from reporting on their equity or debt securities held through DTC because DTC’s participants are U.S. financial institutions that themselves are responsible for information reporting with respect to their payees.
- **Refunds of Withheld Amounts.** FATCA and TEA permit only foreign financial institutions that are entitled to a reduced rate of tax under a tax treaty to receive a refund for overwithheld amounts. TEA additionally requires that any foreign beneficial owner of a payment that claims a refund for overwithheld amounts must provide the IRS with information necessary to determine whether one or more United States persons own more than 10% of the voting power or value of the equity of the foreign beneficial owner and the identity of such 10% United States persons.
- **Reporting By Material Advisors.** FATCA would have required “material advisors” (such as law firms) to file an information return with respect to the formation of certain foreign entities and to identify the foreign entity and the U.S. individuals involved in the transaction. TEA eliminates this provision.
- **Repeal of “Foreign Targeted” Bearer Bond Provisions.** Both FATCA and TEA would repeal the existing exemption from U.S. withholding tax for “foreign targeted bearer bonds” and would impose a 30% withholding tax on interest paid on bearer bonds (and other bonds that are not in registered or book entry form for U.S. tax purposes) issued by U.S. issuers, unless the obligation is (1) issued by a natural person, (2) matures in one year or less, or (3) is not of a type offered to the public. Under TEA, a debt obligation held through a “dematerialized” book entry system

(such as in Japan) would be treated as issued in registered form. The provision is proposed to apply to debt obligations issued after the date that is two years after enactment. Therefore, the provision will not apply to any currently outstanding bearer bond (or bearer bonds issued for the next two years).

Withholding on Dividend Equivalent Payments Under Equity Swaps

- **In General.** Under current law, U.S.-source dividend payments made to a foreign person are generally subject to a 30% withholding tax, but dividend equivalent payments made to a foreign person under an equity swap are generally not subject to the 30% dividend withholding tax.
- Under FATCA, dividend equivalent payments paid 90 days after enactment would have been subject to 30% withholding, unless (and until such time) Treasury or the IRS provided guidance exempting dividend equivalent payments that do not have the potential for tax avoidance. TEA provides a two year “grace period” following its effective date for dividend equivalent payments made on swaps that satisfy the following criteria: (i) the long party does not transfer the underlying stock to any party in connection with the equity swap, (ii) the short party does not transfer the underlying stock to the long party at the termination of the swap, (iii) the underlying stock is readily tradable on an established securities market, (iv) the underlying stock is not posted as collateral by the short party, and (v) the equity swap is not otherwise identified by Treasury as subject to withholding.
- After the grace period, dividend equivalent payments would be subject to withholding unless Treasury issues regulations providing that the swap is deemed to not have potential for tax avoidance and is not subject to withholding. In addition, Treasury would be permitted to reduce the withholding tax to the extent that a taxpayer can establish that tax has already been paid with respect to the dividend (e.g., where the short party actually holds the stock and is subject to withholding).

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If you have any questions regarding the foregoing, please contact any member of the Cadwalader Tax Department.