

Client Alert.

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IRS Issues Guidance on Registered Bonds Days Before Repeal of Bearer Bond Exception

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The Foreign Account Tax Compliance Act (“FATCA”), which was enacted as part of the Hiring Incentives to Restore Employment Act, ends the practice by U.S. issuers (and controlled foreign corporations) of selling bearer debt to foreign investors under “TEFRA C” and “TEFRA D” after March 18, 2012.¹ As a result, debt issued after that date must be issued by U.S. issuers in registered form. FATCA codified Internal Revenue Service (“IRS”) Notice 2006-99, providing that debt obligations cleared through dematerialized book-entry systems would be treated as being issued in registered form. On March 7, 2012, the IRS released Notice 2012-20 (the “Notice”), which addresses, among others, (i) the circumstances under which certain bonds are treated as in registered form, and (ii) a temporary relief from the requirement to collect IRS Forms W-8 in order to qualify for the portfolio interest exemption from U.S. withholding tax on interest. The U.S. Treasury Department said it intends to issue regulations implementing the provisions included in the Notice.

REGISTERED BONDS

The Notice states that a debt obligation will be considered to be in registered form for U.S. federal income tax purposes if the obligation is issued through (i) a dematerialized book entry system in which beneficial interests are transferable only through a book entry system maintained by a clearing organization (or its agent), or (ii) a clearing system in which the obligation is effectively immobilized.

Pursuant to the Notice, an obligation will be treated as immobilized if (i) the obligation is represented by one or more global securities in physical form that are issued to and held by a clearing organization (or its custodian or depository acting as its agent) for the benefit of purchasers of interests in the obligation under arrangements that prohibit the transfer of the global securities except to a successor clearing organization subject to the same terms, and (ii) beneficial interests in the underlying obligation are transferable only through a book entry system maintained by the clearing organization (or its agent).

According to the Notice, dematerialized or immobilized obligations are issued in registered form even if holders may receive bearer bonds in the following circumstances: (i) termination of the clearing organization’s business without a successor, (ii) default by the issuer, or (iii) issuance of definitive securities at the issuer’s request upon a change in tax law that would be adverse to the issuer but for the issuance of physical securities in bearer form. The Notice provides that, if any such circumstance occurs, regardless of whether any option to obtain a physical certificate in bearer form has been exercised, any obligation as to which a holder has a right to obtain a physical certificate in bearer form will no longer be considered in registered form.

¹ For further background with respect to the repeal of the bearer bond exception (and the potential sanctions resulting from non-compliance), please see our prior client alert at <http://www.mofo.com/files/Uploads/Images/100322FATCA.pdf>.

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TEMPORARY RELIEF FROM COLLECTING IRS FORMS W-8

The IRS indicates in the Notice it has received comments that there may be difficulties in obtaining IRS Forms W-8 in certain non-U.S. markets in connection with the issuance of registered debt. Such forms are required to qualify for the portfolio interest exemption from 30% U.S. withholding tax on interest payments.

In response to these comments, the Notice provides that no IRS Forms W-8 are per se required for obligations issued in registered form after March 18, 2012 and before January 1, 2014 provided the obligations are issued in compliance with the “foreign-targeted registered obligation” rules.² However, to qualify for the portfolio interest exemption from the 30% U.S. withholding tax on interest payments, a U.S. withholding agent must receive either (i) IRS Form W-8, or (ii) documentary evidence certifying that the beneficial owner of the registered obligation is not a U.S. person. The “foreign-targeted registered obligation” rules generally require any registered obligations to only be sold to non-U.S. persons pursuant to procedures similar to TEFRA D but permit certain intermediaries to certify as to the holder’s non-U.S. status.

SHORT-TERM DEBT AND EXCISE TAX

The Notice confirms that the TEFRA C and TEFRA D procedures will remain in existence for purposes of an exception from information reporting of interest with respect to certain short-term obligations (term of 183 days or less) and for purposes of avoiding the excise tax (equal to 1% of the principal amount of the obligations times the number of years to maturity) with respect to obligations that are not issued in registered form for U.S. federal income tax purposes.

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Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.

² These rules were suspended by Notice 2006-99 and have now temporarily come back to life.