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The relevance of FATCA

in Swiss finance transactions: On 2 June 2014, the agreement between Switzerland and the United States of America on the cooperation to simplify the implementation of FATCA entered into force. The Swiss Federal Council brought the corresponding implementing act into force on 30 June 2014. This will eliminate uncertainties around FATCA in Switzerland. Accordingly, it is now worthwhile summarising the consequences that FATCA and the implementing Swiss legislation have on debt financing transactions in Switzerland. In this newsletter, suggested approaches to FATCA are discussed in brief.

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The relevance of FATCA in Swiss finance transactions

On 17 January 2013, the US Treasury and the IRS issued final regulations under the Foreign Account Tax Compliance Act (*FATCA*). On 14 February 2013, Switzerland and the US signed an inter-governmental FATCA agreement (*IGA*). The Swiss Federal Act formally implementing FATCA in Switzerland entered into force on 30 June 2014 and uncertainties around the treatment of debt financing transactions in the light of FATCA have been eliminated. Still, payments might become subject to FATCA withholdings. It is, therefore, important to address FATCA and the implementing legislation in the relevant documentation.

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FATCA and General Background

Swiss financial institutions have to implement FATCA as of 1 July 2014. In a nutshell, under FATCA, most foreign (non-US) financial institutions (*FFIs*) are required to disclose certain information in relation to their clients that qualify as specified US persons to the US tax authorities (*IRS*). For these purposes, FFIs will either have to become subject (indirectly) to an IGA (Model 1) or enter into an agreement directly with the IRS (*FFI Agreements*) (Model 2). The Swiss IGA provides for Model 2. Hence, if FFIs enter into FFI Agreements, they qualify as *Participating FFIs*. *Non-Participating FFIs* will suffer a withholding tax at currently 30% on US sourced annual or periodic income and on gross sales proceeds from relevant US property; withholdings will also apply if an FFI is not able to provide the relevant information in relation to a client (carve-outs apply) (*FATCA Deduction*).

In the context of debt financing transactions, the risk is that:

- payments from an US tax obligor (i.e. an obligor that is either (i) formed or organised under the laws of the US or (ii) engaged in a trade or business in the US (or, if a treaty applies, has a permanent establishment in the US) (a *US Tax Obligor*) are subject to a 30% withholding tax in the event that either the agent or any lender is a Non-Participating FFI;
- if an obligor itself is an FFI and either the agent or any lender under the transaction is a Non-Participating FFI, a 30% withholding tax applies on at least a portion of all payments made under the transaction that are treated as «passthru payments» (however, it should be noted that passthru payment withholding has been delayed until the later of 2017 or 6 months after regulations are finalised; IGAs currently reserve on passthru payments); and
- payments among finance parties might become subject to FATCA Deductions in the event that one finance party is a US Tax Obligor and the other finance party is a Non-Participating FFI.

Documentation should therefore address these risks.

Is FATCA a Risk in Swiss Finance?

It appears that FATCA would hardly be relevant in Swiss debt financing transactions as borrowers and guarantors either do not qualify as US Tax Obligors or, if they did, may be clearly identified (still, such identification might be complex; also, US guarantor payments should generally not be treated as US source but the situation would still have to be analysed on a case-by-case basis). Also, from today's perspective, Swiss banks would generally qualify as Participating FFIs and are able to comply with the information obligations, but in situations where they cannot, there is still a risk that FATCA Deductions will have to be made.

Furthermore, (non-Swiss) lenders may not be FATCA compliant and it should be noted that such lenders are hardly eligible as lenders, unless FATCA is properly addressed in the documentation. Hence, while the risk of FATCA Deductions should be remote in Swiss transactions, they cannot be ignored.

Grandfathering

A debt financing will be grandfathered (i.e. not become the subject of FATCA during its term), if committed and/or advanced prior to 1 July 2014, but such grandfathering can be lost, if the transaction is amended after 1 July 2014. Moreover, loans that are considered to be equity for US tax purposes might be subject to a different regime. Finally, it should be noted that at this point, the FATCA regulations relating to passthru withholdings have not been issued.

Borrower or Lender Risk?

In the US lending market, the treatment of FATCA has quickly become a market standard and the LSTA Model Credit Agreement suggests that borrowers and obligors would not have to gross up or otherwise indemnify lenders for any FATCA Deduction, thus, shifting the FATCA risks to the lenders. This is mainly because many lenders in the US market are not FFI's or, if they are, do not face any difficulties in becoming Participating FFIs.

In the European lending market, the position was different, because most lenders qualify as FFIs and there was uncertainty for lenders whether they would be able to be FATCA compliant due to their local banking secrecy or data protection laws regime. It seems that this standard changed in some instances, because there is now generally more certainty around the FATCA treatment.

For Swiss lenders, the issue is almost resolved, provided the FFIs entered into an FFI Agreement and information in relation to the client is available. However, that might not be true for other (prospective) lenders' jurisdictions and thinking about transferability, shifting the risk to the lender might result in a limitation of marketability of the relevant loans. Finally, it is rather uncommon that legal risks are shifted to the lenders. Accordingly, market practice so far suggested that FATCA is a borrower risk (at least where there is no material US obligor), but that might change in the near future, given the increased certainty around FATCA treatment in many jurisdictions.

Drafting Elements

In order to address FATCA risks, a number of drafting points have to be considered and respective language added (in line with LMA's FATCA riders):

General clauses:

- definitions in order to facilitate drafting (e.g. «FATCA», «FATCA Deduction», «FATCA Exempt Party», «US Tax Obligor», etc.)
- information obligations for all parties for any FATCA relevant facts
- resignation obligations for the agent, if the status of the agent would trigger a FATCA Deduction

Clauses shifting the FATCA risk to the obligors:

- representations and covenants by the obligors confirming that no obligor is or will become a US Tax Obligor or a FATCA FFI
- compulsory resignation mechanism for any obligor that becomes a US Tax Obligor or a FATCA FFI
- gross-up obligation of the obligors for any FATCA Deduction made
- clauses permitting the lenders and the agent to make FATCA Deductions on payments among themselves and indemnity/gross-up clauses for the obligors to indemnify

Clauses mitigating obligors' FATCA risk:

- prepayment/cancellation rights in respect of any lender that is not a FATCA Exempt Party (yank the bank)
- finance party that received a tax credit in relation to a FATCA Deduction shall be obliged to make a refund to the relevant obligor

Clauses shifting the FATCA risk to the finance parties:

- provisions allowing each party to make FATCA Deductions, where required
- provisions excluding FATCA Deductions from the obligors' gross-up obligation, tax indemnity obligation and the scope of the increased costs clause

Clauses protecting the grandfathering:

- provisions ensuring that any amendments/accessions of obligors require all lenders' consent
- provisions allowing such amendments/accessions without all lenders' consent, but fully protecting any non-consenting lender from FATCA Deductions

Summary

It is recommended that FATCA be addressed in one way or another, but in circumstances where a financing is granted to a pure Swiss or European group, parties may be able to take a commercial view that FATCA would not have to be addressed at all. More generally, it must be kept in mind that the issue of FATCA can only be fully assessed and resolved with an in-depth US tax analysis rendered on a case-by-case basis

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