This Bulletin provides participants in debt capital markets transactions with guidance on U.S. tax issues raised by the recently-enacted U.S. Hiring Incentives to Restore Employment Act of 2010 (the HIRE Act, or the Act). It begins with a brief summary of the most relevant aspects of the Act, and concludes with frequently asked questions and answers.

The Act became U.S. Public Law 111-147 on 18 March 2010. The provisions described below were originally introduced into Congress as part of the Foreign Account Tax Compliance Act, which became known to the markets as FATCA. The FATCA provisions became law, with amendments, after being incorporated into the HIRE Act. Our prior e-Alerts dated 30 October 2009, 9 December 2009 and 22 March 2010 describe the evolution of the Act at various stages.

The provisions of the Act are in addition to, and not in replacement of, other long-standing provisions of U.S. tax law. For example, the pre-existing U.S. withholding tax regime, covering interest, dividends, and other U.S. source income, remains in place.

Summary of Relevant Provisions of the Act

1. Changes Affecting Bearer Debt Securities (section 502 of the Act)

1.1 Background. The Act makes major changes to the existing TEFRA regime. TEFRA currently requires U.S. and non-U.S. issuers of bearer debt securities with an original maturity of more than one year to implement "reasonable arrangements" to prevent such securities from being sold to U.S. persons in the initial offering. The TEFRA rules provide two ways to satisfy this requirement, which are commonly referred to as TEFRA C and TEFRA D. The TEFRA D requirements include the following: (1) securities must initially be issued in temporary global form exchangeable for permanent global form following a 40-day restricted period; (2) definitive securities must be available at the holder's request after the end of the restricted period; (3) a U.S. tax legend must appear on the face of the securities; and (4) certification by holders of non-U.S. beneficial ownership. TEFRA C requires that the issuer, its agents, distributors and their affiliates do not significantly engage in U.S. "interstate commerce" with respect to the issuance of bearer debt securities. U.S. issuers which comply with the TEFRA rules are currently able to issue bearer debt securities to non-U.S. investors free of U.S. withholding tax (under the portfolio interest exemption) and are entitled to a U.S. tax deduction for the interest paid on such securities.
In addition, both U.S. and non-U.S. issuers must use TEFRA to avoid a U.S. excise tax imposed on issuers of bearer debt securities.

### 1.2 Interest deduction and withholding exemptions

Under the Act debt securities issued on or after 18 March 2012 (the **Effective Date**) must be in registered form for an issuer to claim (1) a U.S. tax deduction, or (2) the "portfolio interest exemption" from 30% U.S. withholding tax, in respect of interest paid on such securities.

The loss of the interest deduction and the requirement to withhold in relation to debt securities which are not in registered form are of concern both to U.S. issuers and to non-U.S. issuers issuing from their U.S. branches. Interest deductibility is also of concern to non-U.S. subsidiaries of U.S. groups because of U.S. foreign tax credit calculations.

### 1.3 Excise tax

Under the Act issuers can avoid the U.S. excise tax (equal to 1% of principal amount multiplied by the number of years to maturity) in respect of bearer debt issued on or after the Effective Date if such debt is issued using arrangements similar to those currently required for TEFRA-compliant issuances. U.S. Treasury regulations may alter the detail of the TEFRA rules for this purpose.

In light of the deductibility and withholding tax sanctions which will be applicable to issuers subject to U.S. tax (see 1.2 above) from the Effective Date, bearer issuances using TEFRA-like restrictions will appeal only to non-U.S. issuers issuing out of a jurisdiction other than the U.S., either directly or through their non-U.S. branches (i.e., where the only concern is the excise tax). Note that the new definition of "registered form" described in 1.4 below may mean that debt that is nominally bearer is regarded as registered for the purposes of the excise tax.

### 1.4 Definition of "registered form"

Under the Act, in addition to securities which are issued in "true" registered form, bearer debt securities issued from the Effective Date in dematerialised book entry systems or "other book entry systems specified by the Secretary [of the Treasury]" will be treated as registered. It is anticipated that regulations will be issued to allow clearing systems using global notes (e.g., Euroclear and Clearstream) to qualify as book entry systems for this purpose.

### 1.5 Certification of non-U.S. status

As mentioned above, the pre-existing U.S. withholding tax regime will remain in effect after the Act comes into force. One consequence of this will be that U.S. issuers of registered debt (and foreign issuers of such securities who seek to issue out of their U.S. branches) will need to obtain withholding certificates on U.S. Internal Revenue Service (I.R.S.) Forms W-8BEN, W-8EXP or W-8ECI, as appropriate, from non-U.S. holders to reduce or eliminate their obligation to withhold tax on interest payments. This requirement will also apply to debt securities that are treated as registered because they are issued in dematerialised form or are held through a specified book entry system (see 1.4 above). This contrasts with the less formal certification of non-U.S. beneficial ownership currently made by holders to a clearing system when TEFRA-compliant bearer debt is issued.

### 2. Changes Affecting Foreign Financial Institutions (section 501 of the Act)

#### 2.1 New withholding tax regime

In addition to compliance with pre-existing U.S. withholding tax rules, under the Act a "foreign financial institution" (FFI) will need to address an additional new set of rules designed to reveal information about "United States accounts" maintained by the FFI. The term FFI could include, e.g., paying agents, common depositories and custodians in the context of a debt securities issue. With effect from 1 January 2013, an FFI will be subject to a 30% U.S. withholding tax in respect of (1) U.S. source investment income, and (2) the gross proceeds from the sale or disposition of U.S. debt or equity instruments, which in both cases it receives either for its own account or for the account of its customers unless it enters into an agreement with the I.R.S. to take certain actions. Among other things, the agreement will require the FFI to (1) identify which of its "financial accounts" is a "United States account", (2) report information to the I.R.S. concerning the owner, size, and income of such accounts, and, in most cases, (3) arrange for 30% withholding to occur with respect to specified income and gross proceeds of sale attributable to a financial account if the owner of such account does not cooperate in providing the required information.

Further detail regarding these requirements can be found in new Internal Revenue Code section 1471(b) in section 501 of the Act. Special rules apply when one FFI has an account with another.

The new withholding rules will not apply to debt securities issued prior to 18 March 2012.

The new sanctions will affect only FFIs which receive income or gross proceeds of the type described, so that FFIs not dealing with U.S. investments on their own behalf or on behalf of their customers will not be affected. FFIs will not be able to avoid the application of the new rules simply by receiving U.S. income and...
The agreement with the I.R.S. must by its terms apply to all group members which are under common majority control in respect of the vote and value of shares or other equity interests.

2.2 Terms defined broadly. The terms quoted above are defined broadly by the Act. For example, an FFI includes not only non-U.S. deposit-taking banks and non-U.S. investment banks, but also non-U.S. investment funds. Thus, hedge funds, private equity funds, and securitisation vehicles are all potentially FFIs. Similarly, a "financial account" includes not only a depository or custodial account, but also any equity or debt interest in an FFI which is not regularly traded on an established securities market. There is currently no guidance on what may constitute regular trading activity for these purposes. Thus, limited partnership interests in non-U.S. private equity funds and notes issued by non-U.S. securitisation vehicles are "financial accounts". A "United States account" includes not only "financial accounts" held by U.S. citizens, but also accounts held by non-U.S. entities which have a 10% U.S. owner.

2.3 Regulatory authority. The Act grants the Treasury broad regulatory authority to alter many of the rules described above. For example, the definition of "financial accounts" could be circumscribed in a manner which excludes certain interests (e.g., unlisted equity interests in banks) from its scope. There is no timetable for the issuance of such regulations.

Frequently Asked Questions

The following are frequently asked questions in relation to the Act. Our answers reflect our reading of the Act and our judgement as to future developments.

When do the provisions affecting bearer securities come into force?

As described more fully at 1.2 above, the HIRE Act changes do not apply to bearer securities issued prior to 18 March 2012.

Does this mean that I can no longer issue bearer securities or can I still rely on the TEFRA C and D?

Bearer securities issued prior to 18 March 2012 can still rely on TEFRA C and D. As described more fully at 1.3 above, TEFRA C and D (perhaps in modified form) will still be available to non-U.S. issuers of bearer securities after that date as a means of avoiding the U.S. excise tax. Therefore, non-U.S. issuers can continue to issue bearer securities after 18 March 2012, provided they do not issue such securities out of their U.S. branches.

Will bearer securities issued through Euroclear and/or Clearstream constitute "registered" securities for U.S. tax purposes?

As described more fully at 1.4 above, it is expected that U.S. Treasury regulations will allow securities cleared through Euroclear and Clearstream to be treated as "registered" for U.S. tax purposes.

When do the provisions relating to the new FFI reporting and withholding regime come into force?

As described more fully at 2.1 above, the new FFI reporting and withholding rules come into force on 1 January 2013. These rules will not apply to securities issued prior to 18 March 2012.

Do I have reporting obligations to the I.R.S. under the new rules?

It depends on who you are. If you are an FFI (broadly defined as per 2.2 above), you will have reporting obligations from 1 January 2013 if you choose to enter into an agreement with the I.R.S. to avoid the new withholding rules.

Will the new 30% withholding tax imposed as a penalty for failure to comply with the new reporting regime replace the existing 30% withholding tax regime?

No. The pre-existing U.S. withholding tax regime will continue to apply. For example, a non-U.S. recipient of interest from a U.S. source will continue to require the benefit of the U.S. "portfolio interest exemption" or of a U.S. tax treaty to escape 30% U.S. withholding. This will be the case even if the recipient is an FFI which has entered into the agreement described at 2.1 above.

Will the new disclosure regime replace the current "Qualified Intermediary" reporting requirements?

No. An FFI which is a QI will need to continue to comply with the procedures of the QI regime, as well as those of the HIRE Act.

What are the penalties if I fail to comply with the requirements of the HIRE Act?

If you are an FFI the most significant penalty will be to suffer 30% withholding on your U.S. source investment income and gross proceeds of sale. If instead you hold an account with an FFI, but refuse to cooperate with it in providing information about your
account which is required by the I.R.S., such income and proceeds attributable to your account may be subject to 30% withholding. In addition, if such an account holder fails to waive the benefit of any bank secrecy laws to which it is entitled, the FFI may be obliged to close the account.

Do I need to do anything to my programme documents?

No changes are needed now to any documents which deal only with issuances to be made prior to 18 March 2012, or which will be updated prior to that time. As stated above, the FFI reporting and withholding requirements will not come into effect until January 2013 and issues made prior to 18 March 2012 will be grandfathered until their maturity.

Documents which cover issuances which could occur on 18 March 2012 or thereafter will need to address the HIRE Act changes. Market practice will also need to evolve to accommodate such changes and to provide, in due course, answers to questions such as those below:

Will I need to include a registered note option in my programme?

It will depend on who you are. If you are a non-U.S. issuer you can continue to issue bearer securities after the Effective Date, without incurring U.S. excise tax if you comply with TEFRA-like restrictions (see 1.3 above) and, consequently, there will be no need to add a registered option to your programme. If you are a U.S. issuer and have a global medium term note programme this will already include registered note provisions. Depending on how registered form is defined for the purposes of the Act (see 1.4 above), if you are a U.S. issuer you may still be able to use any existing bearer provisions in your programme to issue after the Effective Date, since issuances through, e.g., Euroclear and Clearstream which are considered bearer under current rules may be considered to be in registered form under forthcoming regulations. It is likely, however, that the certification requirements of the programme will need to be modified to include the requirement that holders provide I.R.S. forms (see 1.5 above) to receive interest free of withholding.

Will I need to amend the TEFRA selling restrictions in my programme?

If you are a non-U.S. issuer seeking to issue in bearer form on or after the Effective Date it is possible that amendments will need to be made to the TEFRA selling restrictions in your documents. Any amendments will depend on the final U.S. Treasury regulations setting out the TEFRA-like restrictions. If you are a U.S. issuer (and, in some cases, a non-U.S. subsidiary of a U.S. parent) the TEFRA-like restrictions will be of no practical benefit to you (see 1.2. and 1.3 above) and so the TEFRA selling restrictions will be irrelevant for your documents.

Will I need to retain the provision for the exchange of the Global Note into definitive notes "at the request of the noteholder" in my programme?

If you are a U.S. issuer, under current rules this feature requires you to provide definitive notes upon reasonable request of the noteholder and so ensures that bearer securities cleared through Euroclear and/or Clearstream are TEFRA-compliant. In light of the sanctions that would apply under the new rules if you issued in bearer form (see 1.2 and 1.3 above), it is unlikely that you would wish to retain this provision in your programme after the Effective Date.

Will I need to include additional risk factor language on the impact of the HIRE Act in my base prospectus?

When the final regulations are issued, if you are a U.S. issuer you will have to decide on the most appropriate method of disclosing the potential withholding tax risks to note holders and to consider whether additional risk disclosure and/or additional disclosure in the U.S. tax section of your prospectus will achieve this purpose. One of the uncertainties created by the HIRE Act is what will happen when payments cascade through a chain of FFIs, some of which have agreements with the I.R.S. and are compliant with them, and some of which are not. Depending on the final regulations in this area, the risk that the ultimate holder may suffer withholding, even if it and the FFI with which it has direct dealings are compliant, may require disclosure.

Will I need to amend the taxation gross-up and redemption provisions?

Not if you are a non-U.S. issuer. If you are a U.S. issuer, these provisions may need to change. The changes will ultimately depend on market practice as to how the risk of the new withholding tax is apportioned between issuer and investors. Thus, the new withholding tax could end up either being included as triggering a specific gross-up requirement (with the usual issuer right of redemption in the event of such withholding) or it could specifically be carved out of the gross-up provisions altogether.
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