US
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No more bearer bonds?

The Foreign Account Tax Compliance Act of 2009 (the Bill) was introduced in the US Congress at the end of October. If enacted in its current form, the Bill would effectively end the practice whereby US issuers sell so-called bearer bonds to foreign investors.

In 1982, as part of a tax compliance initiative, the Congress passed the Tax Equity and Fiscal Responsibility Act (Tefra) which restricts the issuance of debt instruments in bearer form. Under Tefra, issuers of debt instruments in bearer form are (i) denied deductions of federal income tax on interest paid on such debt instruments and (ii) subject to an excise tax equal to 1% of the principal amount of the bonds multiplied by the number of years until maturity. Various sanctions also apply to holders. Tefra excepts bearer debt instruments that are issued under circumstances in which they are unlikely to be sold to US persons. These circumstances include foreign-targeted bearer debt instruments that comply with Treasury regulations referred to as Tefra C and Tefra D. No distinction is made between US and foreign issuers for purposes of the sanctions under Tefra so that, as a technical matter, foreign issuers of bearer bonds are equally subject the excise tax unless they are issued in compliance with Tefra C or Tefra D.

In 1984 Congress repealed the 30% withholding tax on US-source portfolio interest paid to foreign investors. A coordination rule only permits the exception for interest on bearer debt sold under Tefra restrictions.

The Bill would end the practice of selling bearer bonds to foreign investors under Tefra C and Tefra D. So for issuers of foreign-targeted bearer bonds, the Bill would repeal the exception to the sanctions on the issuer and holder of bearer bonds imposed under Tefra. In particular, issuers would be subject to the excise tax and interest paid on such bonds would no longer qualify for treatment as portfolio interest, subjecting it to 30% withholding tax. This provision would be effective for debt obligations issued more than 180 days after the date of enactment of the Bill.

If enacted, the collateral damage from the Bill in the capital markets is difficult to gauge. What is clear is that US issuers would have to revise their existing programmes to prohibit bearer debt. More importantly, they would have a harder time raising capital in foreign jurisdictions if those jurisdictions are unwilling to provide the non-US person certification required for registered debt (IRS Form W-8). Also, foreign issuers would no longer have the protection against the excise tax of Tefra C or Tefra D and would instead run the risk that the US would attempt to impose an excise tax on a purely foreign-to-foreign debt offering.

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