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LEGAL ALERT

August 21, 2012

A New FATCA Derivative: ISDA Publishes Protocol Designed To Address the Implications of FATCA on Derivatives Transactions

On August 15, the International Swaps and Derivatives Association, Inc. (ISDA) published the 2012 ISDA FATCA Protocol (the FATCA Protocol). The FATCA Protocol is intended to address the implications of the Foreign Account Tax Compliance Act (FATCA) on derivatives transactions documented under an ISDA Master Agreement. Currently the form ISDA Master Agreements do not cover the tax obligations and withholding imposed by FATCA, so these items must be addressed separately in a Schedule or, now, by adoption of the FATCA Protocol.

Where the FATCA Protocol is adopted by both parties to an ISDA Master Agreement, the agreement will be treated as having been amended to include the following provision:

> <u>Withholding Tax imposed on payments to non-US counterparties under the United States Foreign Account Tax Compliance Act</u>. "Tax" as used in Part 2(a) of this Schedule (Payer Tax Representation) and "Indemnifiable Tax" as defined in Section 14 of this Agreement shall not include any U.S. federal withholding tax imposed or collected pursuant to Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), any current or future regulations or official interpretations thereof, any agreement entered into pursuant to Section 1471(b) of the Code, or any fiscal or regulatory legislation, rules or practices adopted pursuant to any intergovernmental agreement entered into in connection with the implementation of such Sections of the Code (a "FATCA Withholding Tax"). For the avoidance of doubt, a FATCA Withholding Tax is a Tax the deduction or withholding of which is required by applicable law for the purposes of Section 2(d) of this Agreement.

The provision is substantially similar to the language that many parties have included in ISDA Schedules negotiated subsequent to the enactment of FATCA. The FATCA Protocol allows parties to extend this language to previously negotiated agreements, without the need for a formal amendment to those agreements.

The effect of the adoption of the FATCA Protocol is to allocate the burden of any FATCA Withholding Tax to the payee. The economic burden of any FATCA Withholding Tax is appropriately allocated to the payee because it is the party with the ability to obtain an exemption from the FATCA Withholding Tax.

The primary benefit to a party that becomes a signatory to the FATCA Protocol is that the FATCA Protocol will apply to any existing, outstanding Master Agreements as well as new Master Agreements, in either case assuming the counterparty is also signatory to the FATCA Protocol. The adhering parties are listed on the ISDA website. If a party has a number of outstanding Master Agreements that are not anticipated to be renegotiated, becoming a signatory the FATCA Protocol can help mitigate the risk of any withholding under FATCA and ensure the consequences of any FATCA Withholding Tax are adequately addressed.

For agreements negotiated now or in the future, including FATCA provisions in a Schedule to the Master Agreement generally is preferable to adopting the protocol. When negotiating a Schedule to an ISDA Master Agreement, it is appropriate to consider also including a specific requirement that the parties provide any forms or documentation required by FATCA. ISDA indicated that a forms requirement was not included in the FATCA Protocol because the specific forms are still being developed by the IRS, and the allocation of the withholding tax risk to the payee and the indemnification under the FATCA rules for payers that do withhold generally will protect the payer in the event the payee does not provide the form. Notwithstanding the limited risk to the payer when the payee does not provide the form, in order to ensure compliance with FATCA, it is recommended that parties specifically request FATCA forms from their counterparties.

Notably, the primary drafters of the FATCA Protocol indicated that the FATCA Protocol is intended to be a base and that adhering parties can add provisions as desired.

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If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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