

TaxTalk



Editor's Note

As tax lawyers we were interested to see the decision by the U.S. Supreme Court in *National Federation of Independent Business v. Sebelius* holding that the IRC Section 5000A(1)(b) "shared responsibility payment" provided for individuals that do not obtain health insurance beginning in 2014 is a tax. However, lost in the commotion was the fact that upholding the Affordable Care Act also means that as of January 1, 2013 the U.S. will have a new 3.8% tax on investment income including capital gains. Coupled with expiration of the Bush era tax cuts, this will mean a significant increase in federal taxes on investment income. The chart below shows the maximum federal income tax rate, assuming no changes to current law, that applies to an individual earning in excess of the threshold amount with respect to three categories of investment income for the years 2012 and 2013 (both taking and not taking into account the Medicare contribution tax starting in 2013).

	2012	2013 (without Medicare)	2013 (with Medicare)
Dividends	15%	39.6%	43.4%
Interest	35%	39.6%	43.4%
Long-Term Capital Gain	15%	20%	23.8%

Apart from the historic *National Federation* decision, Q2 had a bit of everything. The Internal Revenue Service ("IRS") and the Treasury Department ("Treasury") announced a third approach to FATCA implementation that is a hybrid between the FFI Agreement and the intergovernmental approach announced in February,¹ and released a draft version of Form W-8 to account for FATCA withholding. The Tax Court issued two rulings addressing the characterization of debt and equity in *Hewlett-Packard Co. v. Commissioner* and *NA General Partnership v. Commissioner*. Additionally, Federal banking agencies released proposed changes to the U.S. regulatory capital framework, to which many financial institutions reacted rather quickly by redeeming outstanding trust preferred securities. To conclude this edition, we have our regular features, *Press Corner* and *MoFo in the News*.

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¹ See MoFo's prior client alert at <http://www.mofo.com/files/Uploads/Images/120214-Withholdable-Payment.pdf>.

IRS Advisory Memo Finds Parent Cannot Claim Subsidiary's Stock is Worthless While Tax Refund is Pending

In May 2012, the IRS released an advisory memo² addressing whether the parent of a consolidated group can claim a deduction for a subsidiary's worthless stock when the subsidiary continues to hold tax refund claims. In the memo, the taxpayer ("Taxpayer") is the common parent of a consolidated group that included an insolvent subsidiary. During the taxable year, Taxpayer's consolidated group incurred a large consolidated net operating loss ("NOL"), all of which was attributable to the subsidiary. By the end of the tax year, the subsidiary ceased its business operations, disposed of its operating assets, and used the proceeds to pay some of its creditors. The subsidiary continued to hold some assets, including legal claims against its directors and officers, as well as the right to a share of the tax refund attributable to the carryback of the NOL.³ The retained assets were worth less than the amount of the subsidiary's unpaid liabilities. At first blush, the stock of the subsidiary held by the Taxpayer was worthless under Section⁴ 165(g), which allows holders of worthless stock to treat the stock as disposed of in a sale or exchange in the year in which the

stock becomes worthless.

Special rules apply, however, to the stock of a subsidiary in a consolidated group. According to Treasury regulations under Section 1502, stock is not considered worthless for Section 165 purposes until all of the subsidiary's assets are treated as disposed of.⁵

According to the advisory memo, the subsidiary's share of the refund claim, as well as its legal claims, constitute property, and therefore the subsidiary has not disposed of all of its assets. As a result, the subsidiary's stock did not meet the standard for worthlessness set forth in the regulations. The advisory memo notes that until 2008, it was only necessary for a subsidiary to have disposed of "substantially all" of its assets in order to meet the standard for worthlessness. In making this requirement stricter by requiring the disposition of all property (except for its corporate charter or any assets necessary to satisfy state law minimum capital requirements), the regulations sought to "prevent gain or loss on stock from being taken into account by the group until after items flowing from the subsidiary's activities are taken into account by the group." This decision appears to reflect a preference for viewing consolidated groups as a single entity, rather than as an aggregation of entities.

Tax Court Recharacterizes Preferred Equity as Debt in Hewlett-Packard Case

In *Hewlett-Packard Co. v. Commissioner*,⁶ the Tax Court recharacterized preferred equity owned by Hewlett-Packard

Co. ("HP") in a Dutch corporation as indebtedness and denied HP foreign tax credits and a capital loss on the exit transaction.

Background

In 1996, HP bought \$202 million of preferred shares in Foppingadreef ("FOP"), an entity incorporated in the Netherlands Antilles. Under the shareholders' agreement, FOP's directors were required to declare dividends on the preferred to the extent profits were available to be paid out to HP. Furthermore, HP had the right to put the preferred shares to ABN AMRO Bank N.V. ("ABN"), FOP's common shareholder, for their fair market value. In the event that ABN defaulted on its obligation to buy the shares from HP, HP had the right to put the shares back to FOP at FMV or force FOP to liquidate.

During the course of HP's ownership of the preferred shares, FOP paid foreign taxes which entitled HP as the owner of the preferred shares to take into account foreign tax credits. In 2003, HP put the preferred shares to ABN and claimed a \$15.5 million loss on the transaction. The IRS challenged HP's foreign tax credit claim, as well as its exit transaction loss, on three alternative theories: (i) that the stake in FOP was more appropriately characterized as debt, and not equity; (ii) that the investment was a sham under the economic substance doctrine; and (iii) that, under the step transaction doctrine, FOP was a conduit for a loan from HP to ABN. Tax Court Judge Joseph Goeke's decision that the FOP investment was more akin to a loan than an equity interest mooted the latter two issues.

Tax Court Opinion

The Tax Court applied the Ninth Circuit's 11-factor test for characterizing debt versus equity.⁷ In order to analyze the instrument, the Tax Court first considered whether or not HP's put option should be integrated with the investment. HP argued that the put option should not be integrated because it

² AM 2012-003.

³ The advisory memo does not mention a tax sharing agreement nor does it discuss the reason the subsidiary had claim to part of the refund.

⁴ All Section references are to the Internal Revenue Code of 1986, as amended (the "Code") and the Treasury regulations promulgated thereunder.

⁵ Subsidiary stock is also treated as worthless if the subsidiary for any reason ceases to be a member of the group.

⁶ TC Memo 2012-172.

⁷ *A.R. Lantz Co v. United States*, 424 F.2d 1330 (9th Cir. 1970) (citing *O.H. Kruse Grain & Milling v. Commissioner*, 279 F.2d 123, 125-126 (9th Cir. 1960), aff'g T.C. Memo. 1959-110).

HP Case

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was not binding on FOP, but rather on FOP's common shareholder, ABN. The Tax Court disregarded this distinction, finding that the put option was part of a package of agreements signed at the FOP closing, that the put option was referenced in the shareholder agreement, and that FOP was inextricably connected to the exercise of the put option.

In applying the 11-factor test to the integrated investment, the Tax Court spent considerable time addressing whether the instrument contained a fixed maturity date and whether HP was afforded creditor's rights. Although HP argued that the presence of a put option should not be construed as a maturity date, the Tax Court found that all parties expected HP to exit the transaction through the put option in 2003. Additionally, "FOP's articles of incorporation and various agreements pertaining to FOP afforded HP an apparatus to enforce creditor rights."

The Tax Court also found that even though HP was nominally entitled to receive dividends from FOP's earnings, indicating an equity interest, the earnings of FOP were predetermined, "assuring that FOP would have sufficient earnings to make the agreed periodic payments to HP." As to whether or not HP enjoyed management rights in FOP, the court held that HP did not value those rights, and therefore, the court would "ascribe the same weight to HP's objectively meaningful voting rights as it did over the term of the transaction."

Finally, the Tax Court found that although HP was nominally subordinated to all claims of indebtedness against FOP, FOP was prohibited from having material creditors, and therefore, "HP's rights would never be subordinated to any creditor's."

The Tax Court then turned to whether the loss HP incurred upon exiting the transaction should be disallowed. The court suggested that the \$15 million decline in value on the investment represented a fee for participation in a tax shelter. Because HP could not carry its burden of showing

that this fee should be deductible, the court disallowed the loss on the transaction.

NA General Partnership v. Commissioner Addresses Debt-Equity Characterization of Related-Party Advances

In *NA General Partnership v. Commissioner*⁸ the Tax Court held that notes issued to a parent by a subsidiary in connection with the acquisition of a target were properly characterized as debt and were not equity for tax purposes.

Background

Beginning in 1998, ScottishPower, a "multi-utility business in the U.K.," sought to acquire PacifiCorp, an Oregon-based publicly traded utility company. In order to effectuate the merger, ScottishPower used its indirect subsidiary NA General Partnership & Subsidiaries ("NAGP") to acquire 100% of PacifiCorp. In exchange for their shares, the PacifiCorp stockholders were entitled to receive ScottishPower American Depository Shares or common shares. NAGP issued loan notes to ScottishPower, \$4 billion in fixed-rate notes and \$896 million in floating-rate notes.

NAGP failed to make interest payments in 2000, and paid \$333 million of the \$355 million accrued interest in 2001. NAGP eventually borrowed additional amounts from ScottishPower and from Royal Bank of Scotland in order to maintain its interest payments. In March 2002, ScottishPower made contributions to NAGP, which used the funds to pay the remaining principal and interest on the loans. In total,

⁸ TC Memo 2012-172.

NAGP claimed \$932 million in interest expenses on the loans, which the IRS disallowed, recharacterizing the funds advanced pursuant to the notes as capital contributions by ScottishPower.

Tax Court

Tax Court Judge Diane Kroupa applied the 11-factor test for characterizing debt versus equity used in *Hardman v. United States*, 827 F.2d 1409 (9th Cir. 1987), and found that the factors weighed more heavily in favor of debt than equity. First, payments on the loans were required to be made regardless of NAGP's earnings. Furthermore, the notes' subordination to new debtors was found to be relatively less important in the context of loans made to a related party. Finally, the court gave weight to evidence that the parties subjectively intended to enter into a debtor-creditor relationship. Wrote Kroupa, "we recognize that there are features in this case pointing to both debt and equity. Nevertheless, in view of the record as a whole, we find that the advance was more akin to debt than equity."

IRS Rules that Money Market Fund Shares are "Cash" for REIT Asset Test Purposes

On June 18, 2012, the IRS issued Revenue Ruling 2012-17, which addressed whether shares in a money market fund are categorized as "cash and cash items" for purposes of the 75 percent value test of Section 856. According to the ruling, money market shares qualify as "cash and cash items" for REIT purposes.

There is no definition of "cash and cash items" contained in Section 856. Noting that Section 856(c)(5)(F) provides that any term not defined in Section 856 shall have the same meaning as when used in the Investment Company Act of 1940 ("the 1940

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REIT Asset Test Ruling

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Act”), the IRS analyzed whether money market fund shares were defined within the meaning of the 1940 Act.

Although the term “cash item” is not defined in the 1940 Act or the regulations promulgated thereunder, the IRS noted that there was a No-Action Letter issued by the SEC’s Division of Investment Management that was directly on point. In the No-Action Letter, the issue was whether money market fund shares were “cash items” or investments for purposes of determining whether the issuer of the shares was an investment company within the meaning of the 1940 Act. The No-Action Letter held that money market fund shares may be treated as “cash items,” finding that the “essential qualities” of cash items are “high degree of liquidity and relative safety of principal” and that money market fund shares possess these same qualities.

The IRS noted that this analysis is not inconsistent with Section 856 or its legislative history and concluded that money market fund shares may be treated as cash items for REIT asset test purposes. The ruling concludes by pointing readers to Revenue Procedure 89-14, which cautions against relying on a revenue ruling that is based on an interpretation of nontax law without first checking to see whether the relevant nontax law has changed materially.

Redemption of Trust Preferreds Following New Federal Reserve Capital Rules

On June 7, 2012, the Federal banking agencies (the OCC, Federal Reserve Board and FDIC) (the “Agencies”) formally proposed for comment, in three separate

but related proposals, significant changes to the U.S. regulatory capital framework: the Basel III Proposal, which applies the Basel III capital framework to almost all U.S. banking organizations; the Standardized Approach Proposal, which applies certain elements of the Basel II standardized approach for credit risk weightings to almost all U.S. banking organizations; and the Advanced Approaches Proposal, which applies changes made to Basel II and Basel III in the past few years to large U.S. banking organizations subject to the advanced Basel II capital framework.⁹ The publication of these proposals constitutes, for most issuers, a Tier 1 capital event under the terms of their outstanding trust preferred securities, and as a result permits them to call their trust preferreds.

Basel III Proposal

This proposal is applicable to all U.S. banks that are subject to minimum capital requirements, including Federal and state savings banks, as well as to bank and savings and loan holding companies other than “small bank holding companies” (generally bank holding companies with consolidated assets of less than \$500 million). There will be separate phase-in/phase-out periods for minimum capital ratios; regulatory capital adjustments and deductions; non-qualifying capital instruments; capital conservation and countercyclical capital buffers; supplemental leverage ratio for advanced approaches banks; and changes to the Agencies Prompt Corrective Actions (“PCA”) rules. Almost all of these changes would be effective by January 1, 2019.

Common Equity Tier 1 Capital would be the sum of outstanding common equity tier 1 capital instruments and related surplus (net of treasury stock), retained earnings, accumulated other comprehensive income, and common equity Tier 1 minority interest, minus certain adjustments and deductions. Unrealized gains and losses on all available-for-sale securities held by

the banking organization would flow through to common equity Tier 1 capital. Qualifying common equity Tier 1 capital would have to satisfy 13 criteria that are generally designed to assure that the capital is perpetual and is unconditionally available to absorb first losses on a going-concern basis, especially in times of financial stress.

Standardized Approach Proposal

This proposal would be generally applicable to the same banks that would be subject to the Basel III Proposal. The proposed effective date is January 1, 2015, but banks have the option to adopt rules earlier. The proposal revises a large number, although not quite all, of the risk weights (or their methodologies) for bank assets. For nearly every class, the proposal requires a more complex, detailed and calibrated assessment of credit risk and calculation of risk weightings.

Advanced Approaches Proposal

This proposal applies to banking organizations that are subject to the “advanced approaches” rule under Basel II, including qualifying Federal and state savings associations and their holding companies. It addresses counterparty credit risk, removal of credit rating references, securitization exposures, and conforming technical changes. It also proposes the expansion of those banking organizations that are subject to the market risk capital rule.

Effect on Tax Deductible Bank Equity

As anticipated, the NPR would make the issuance of tax deductible bank equity much more difficult. For example, in the proposal, the banking agencies go beyond Basel III and note that instruments that are debt for GAAP purposes would not qualify as Tier 1 equity. The banking agencies have requested comment on this, and we anticipate that commenters may note that the more stringent U.S. requirement will put depository institutions in the United States at something of a competitive disadvantage.

The NPR, however, does leave some

⁹ See MoFo’s prior client alert at <http://www.mofo.com/files/Uploads/Images/120613-Federal-Banking-Agencies-Regulatory-Capital-Proposals-Summary.pdf>.

New Federal Reserve Capital Rules

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room for “REIT preferred.” In a REIT preferred transaction, the bank sets up a subsidiary that elects to be taxed as a real estate investment trust (“REIT”) for federal income tax purposes. The bank contributes cash or assets in exchange for the REIT’s common stock. The REIT issues non-cumulative perpetual preferred stock to investors. The terms of the REIT preferred provide that it will convert to bank stock upon the occurrence of certain regulatory events. The REIT uses the proceeds from the sale of the preferred and common stock to acquire qualifying REIT assets, e.g., mortgage loans either from the bank or in the market. Income on the assets is used to pay distributions on the REIT preferred with the remaining income being paid as dividends on the common stock. Because the REIT is a pass-through for federal income tax purposes, the transaction achieves the equivalent of a deduction for federal income tax purposes, that is, income on the REIT’s assets to the extent distributed on the REIT preferred is not subject to a corporate level tax. From a bank regulatory standpoint, the REIT preferred is treated as Tier 1 capital, e.g., equity in a subsidiary. Such transactions have been undertaken since the mid-1990s by banks including Chase Manhattan Bank. More recently, in 2006 Washington Mutual Bank issued a REIT preferred that converted into Washington Mutual, Inc. stock when Washington Mutual, Inc. went bankrupt in 2008.

The NPR requires that the REIT be an “operating company.”¹⁰ It is not entirely clear what this means, however, it potentially means that the REIT must be in a profit-making business facing customers. Moreover, the NPR advises that the REIT structure must contemplate suspension of dividends on the REIT preferred. The concern here is that the REIT preferred is effectively cumulative because the REIT

must pay dividends to avoid an entity level tax. The NPR, however, provides that a consent dividend procedure, where the common shareholder (e.g., the bank) consents to include the REIT’s taxable income in its income even though no dividend is paid on the REIT preferred or the REIT common could be sufficient. Moreover, REIT preferred is subject to the limits on minority interest set forth in the NPR. The utility of REIT preferred may be limited by the cap on minority interests, also set out in the NPR.

Redemption of Trust Preferreds

In connection with the proposed regulations and the related Tier 1 capital event, financial institutions are redeeming outstanding trust preferred securities due to the loss of Tier 1 capital status. For example, on June 11, 2012, JP Morgan Chase & Co. announced that certain of its trusts will redeem all of the issued and outstanding trust preferred capital securities.

Draft Form W-8 Released for FATCA Implementation

The IRS has released draft versions of revised Forms W-8 that allow foreign financial institutions (“FFIs”) to certify the status of beneficial accountholders that might otherwise be subject to withholding

¹⁰ In the Standardized Approach (SA) release the reference to operating company states: “Under the proposal, an operating company would not fall under the definition of a traditional securitization (even if substantially all of its assets are financial exposures). For purposes of the proposed definition of a traditional securitization, operating companies generally would refer to companies that are set up to conduct business with clients with the intention of earning a profit in their own right and generally produce goods or provide services beyond the business of investing, reinvesting, holding, or trading in financial assets. Accordingly, an equity investment in an operating company, such as a banking organization, generally would be an equity exposure under the proposal. In addition, investment firms that generally do not produce goods or provide services beyond the business of investing, reinvesting, holding, or trading in financial assets, would not be operating companies for purposes of this proposal and would not qualify for this general exclusion from the definition of traditional securitization.”

under FATCA. The Forms W-8BEN, “Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding (Individual),” and W-8BEN-E, “Certificate of Status of Beneficial Owner for United States Tax Withholding (Entities),” are available on the IRS website.¹¹ The draft Form W-8 for entities adds new sections for the financial payee that submits the form to identify its status under FATCA.

IRS Issues Guidance on When COD Income Is “Qualifying Income” For Purposes of the Publicly Traded Partnership Provisions

On June 15, 2012, the IRS issued guidance on when cancellation-of-indebtedness (“COD”) income is treated as “qualifying income” for purposes of determining whether publicly traded partnerships (“PTP”) must be treated as corporations under Section 7704. According to Rev. Proc. 2012-28, the IRS will not challenge a PTP’s determination that COD income is qualifying income under section 7704(d) as long as the taxpayer shows, by any reasonable method, that the debt was incurred in direct connection with activities generating qualifying income (“qualifying activities”).

One reasonable method by which the taxpayer can show that debt was incurred in direct connection with activities generating qualifying income is by tracing

¹¹ <http://www.irs.gov/pub/irs-utl/formw8benindividualcirculation2.pdf> and <http://www.irs.gov/pub/irs-utl/formw8benentityexccirculation2.pdf>.

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COD Income and PTPs

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the funds to qualifying activities. Ordinarily, however, “a method that allocates COD income based solely on the ratio of qualifying gross income to total gross income will not be considered reasonable.” Taxpayers may request a private letter ruling on whether a method is reasonable.

U.S. Treasury and Japan/Switzerland Announce They Will Negotiate Toward a “Third Way” for FATCA Compliance

As we have previously reported, FATCA is becoming a significant concern to foreign banks, brokers and investment funds because of its potentially far reaching scope. When FATCA’s “withholdable payment” rules take effect in 2014, Sections 1471 through 1474 of the Code will require that an FFI has signed an agreement (“FFI Agreement”) with the IRS in order to avoid a 30% U.S. withholding tax on U.S. source interest, dividends and sales proceeds, as well as on “passthru payments.”

One of the concerns expressed by FFIs is that the exchange of information pursuant to an FFI Agreement violates privacy laws of foreign countries. Because of these concerns, in February the Treasury released a joint statement from the U.S., France, Germany, Italy, Spain, and the United Kingdom regarding an intergovernmental approach to improving international tax compliance and implementing FATCA. The joint statement noted that the U.S. is open to adopting an

intergovernmental approach to implement FATCA and improve international tax compliance and is willing to reciprocate in collecting and exchanging on an automatic basis information on accounts held in U.S. financial institutions by residents of France, Germany, Italy, Spain, and the United Kingdom (i.e., a country-to-country information sharing model).

Thus, in addition to strict compliance with Sections 1471 through 1474 (e.g., signing an FFI Agreement), the February announcement reflects a second approach designed to achieve FATCA’s goal of increased compliance with U.S. tax law.

On June 21, 2012, Treasury issued joint statements with Switzerland and with Japan that contemplate a third approach for implementation of FATCA. This third approach is a hybrid between the straight FFI Agreement and the intergovernmental approach referred to above, in which FFIs would satisfy their reporting requirements by reporting directly to Treasury, supplemented by exchange of information between the relevant countries upon request while at the same time simplifying the implementation of FATCA.

Swiss Framework

The U.S.-Swiss joint statement explains that the U.S. and Switzerland would enter into an agreement pursuant to which Switzerland:

- (i) would direct all non-exempt or non-deemed-compliant Swiss financial institutions to enter into an FFI Agreement with the IRS,
- (ii) enable Swiss financial institutions to comply with the obligations set forth in the FFI Agreement by granting an exception to the criminal prohibition on actions for the benefit of a foreign state, and
- (iii) provide additional information about U.S. recalcitrant accounts as requested by Treasury pursuant to the exchange of information provisions included in a protocol to the U.S.-Swiss tax treaty.

In exchange, the U.S.:

- (i) will expand the categories of

deemed-compliant and exempt FFIs for Swiss institutions (e.g., small, local FFIs),

- (ii) eliminate U.S. withholding under FATCA on payments to Swiss financial institutions (i.e., by identifying all Swiss financial institutions as participating FFIs or deemed-compliant FFIs, as appropriate), and
- (iii) agree to certain other appropriate measures to reduce burdens and simplify the implementation of FATCA.

Additionally, Swiss financial institutions would not be required to:

- (i) terminate the account of a recalcitrant accountholder, and
- (ii) impose foreign passthru payment withholding on payments to recalcitrant account holders, or to other financial institutions in Switzerland, or in another jurisdiction with which the U.S. has in effect either an agreement for an intergovernmental approach to FATCA implementation, or an agreement for intergovernmental cooperation to facilitate FATCA implementation.

Japanese Framework

Similarly, the joint statement with Japan explains the framework that the relevant U.S. authorities (Treasury and IRS) would enter into with the relevant Japanese authorities (the Ministry of Finance, the National Tax Agency and the Financial Services Agency) under which the Japanese authorities would agree to:

- (i) direct and enable financial institutions in Japan, not otherwise exempt or deemed-compliant, to register with the IRS and confirm their intention to comply with official guidance issued by Japanese authorities that is consistent with the obligations of participating FFIs under FATCA, and
- (ii) provide additional information about U.S. recalcitrant accounts as requested by Treasury pursuant to the exchange of information provisions

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Third Approach for FATCA Implementation

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included in the U.S.-Japan tax treaty.

The relevant U.S. authorities would agree to:

- (i) eliminate the obligation of each FFI in Japan to enter into a separate FFI agreement, provided that each FFI is registered with the IRS or is excepted from registration,
- (ii) identify specific categories of Japanese financial institutions or entities that would be treated as deemed-compliant or exempt due to presenting a low risk of tax evasion (e.g., certain Japanese pension funds), and
- (iii) eliminate U.S. withholding under FATCA on payments to financial institutions in Japan that have registered or entered into an FFI agreement with the IRS and conduct due diligence and reporting in a manner consistent with FATCA requirements or are treated as deemed-compliant or exempt pursuant to the agreed upon framework.

Similar to the U.S.-Swiss proposed agreement, financial institutions in Japan that comply with their obligations would not be required to:

- (i) terminate the account of a recalcitrant account holder, or
- (ii) impose passthru payment withholding on payments to recalcitrant account holders, to FFIs organized in Japan that have registered or entered into an FFI agreement with the IRS, or are otherwise exempt or deemed compliant, or to FFIs in another jurisdiction with which the U.S. has in effect either an agreement for an intergovernmental approach or an agreement for

intergovernmental approach.

This third approach announced last week effectively represents a country-by-country modification of the FATCA rules. Under this system all financial institutions in the country would be identified to the IRS and either be exempted or agree to share information about U.S. account holders. (For example, the joint Swiss-U.S. statement mentions "certain small, local FFIs and institutions/schemes in the field of the Swiss pension system" that could be exempted.) In exchange, all such country's FFIs would be exempt from Section 1471 withholding tax. Also, identification of recalcitrant account holders (e.g., ones who refuse to comply with a request for information) would occur on an aggregate basis under existing treaty obligations rather than FFI-by-FFI. Finally, the participating country's FFIs would be exempt from the onerous passthru payment rules.

Interestingly, this per country approach is not uniform. Under the Swiss version, Swiss FFIs would enter into FFI Agreements with the IRS. Under the Japanese version, non-exempt Japanese FFIs would register with the IRS and confirm their intention to comply with official guidance issued by Japanese authorities that is consistent with the obligations of participating FFIs.

The joint statements merely announce an intent to negotiate or explore agreements along the foregoing lines. No date is set forth for actual agreements although presumably they would be in force beginning in 2014, when FATCA would otherwise take effect.

For all FATCA updates, including the joint statements, see our FATCA website at KNOWFatca.com.

Press Corner

The New York state legislature has found a way to replace a tax break for in-state craft beer brewers. The new legislation replaces a per-gallon tax exemption, which was struck in a lawsuit brought by a Massachusetts brewer, with an equivalent tax credit. "We believe the governor and lawmakers recognize the contribution our

industry is making to reviving the state's economy and are hopeful they will give us the help we need to continue to add jobs and keep prices down for our loyal customers," said David Katleski, president of the New York Brewers Association. The new legislation also permits craft beer to be sold at farmers' markets.¹²

Circular 230 could be getting a makeover. Treasury Acting Assistant Secretary for Tax Policy Emily McMahon at a luncheon sponsored by the District of Columbia Bar Association said that new rules are expected this summer. "I think it's fair to say that the covered opinion rules have not really been working as they were intended. The standards have been pretty difficult to apply and have led to a proliferation of circular 230 disclaimers on all sorts of documents including emails."¹³

The British government is paying the price for trying to put its hands on other people's hot pies. The announcement of a new value-added tax on pasties, savory pies filled with meat and vegetables, led to protests against the coalition government, causing the government to change course and drop the pasty tax. The tax was meant to bring pasties in line with other takeout foods, which are subject to sales tax.¹⁴

The early bird gets the tax bill? In 2002, officials in Indianapolis decided to forgive the tax burden of property owners opting to finance a new sewer system through installment payments over a number of years. The only problem? Some property owners opted to pay the tax up front in a lump sum, and the city chose not to refund the money. The Supreme Court upheld the city's course of action against equal-protection complaints, applying a highly deferential standard. The 6-3 majority noted that the burden of a refund system provided the city with a rational basis for making its decision.¹⁵

¹² See "N.Y. Serves Up Tax Break for Beer Brewers," *The Wall Street Journal*, June 13, 2012.

¹³ See "IRS Planning New Rules on Circular 230 This Summer, McMahon Tells Practitioners," 119 DTR G-10, *Daily Tax Report*, BNA (June 21, 2012).

¹⁴ See "U.K. Backs Down on 'Pasty Tax,'" by Ainsley Thomson, *The Wall Street Journal*, May 29, 2012.

¹⁵ See "Roberts is Outraged at a Tax; Thomas Isn't," by Brent Kendall, *The Wall Street Journal*, June 4, 2012.

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MoFo in the News

On April 11, 2012, MoFo held a Tokyo teleconference titled “Understanding the New U.S. Derivative Trading Rules.” The teleconference provided a status report on the progress of rulemaking under the Dodd-Frank Act and discussed which rules have been finalized, which rules remain to be finalized, the timeline for remaining rule making, implementation and what to do now if you are a dealer.

Also on April 11, 2012, MoFo partner David Lynn participated in the PLI One Hour Briefing, “The JOBS Act: A Dialogue with Senior Staff from the SEC Division of Corporation Finance and Private Practitioners,” where senior staff members from the Securities and Exchange Commission’s Division of Corporation Finance and two leading practitioners discussed some of the key provisions of the JOBS Act and provided practical advice.

MoFo partners David Lynn and Anna Pinedo joined the JOBS Act Teleconference panel on April 12, 2012, titled “Get a Jumpstart with Practice Pointers – Registered Offerings after the JOBS Act.” Panelists focused on the practical implications for issuers already in registration, for issuers contemplating an IPO, and for underwriters and other advisers working with emerging growth companies.

David Lynn and Anna Pinedo also joined the JOBS Act Teleconference panel on “Get a Jumpstart with Practice Pointers – Private Offerings after the JOBS Act and Section 3(b) Exempt Offerings” on April 13, 2012. Panelists addressed guidance for private offerings during the interim period prior to SEC rulemaking, and also covered the following: lifting of the General Solicitation/General Advertising Ban on Rule 506 Offerings, analogous changes to Rule 144A, practical documentation implications for private placements and Rule 144A offerings, new 3(b)(2) Exemption Details/Comparison to Reg A, 3(b)(2) offerings as a precursor to

an IPO or an alternative to a Rule 144A equity offering, preemption, and role of an investment bank in a 3(b)(2) offering.

On April 16, 2012, David Lynn and Anna Pinedo joined the PLI Private Placements and Other Financing Alternatives 2012 where PLI faculty analyzed current developments in private placements and hybrid financing transactions, including proposed changes to Regulation A and other changes to the private offering regime, Private Investments in Public Equity (PIPEs), registered direct offerings, wall-crossed offerings, and change-of-control transactions. They discussed the basics of private placements and other exempt offerings, as well as recent regulatory reform related and SEC developments involving exempt offerings. They also discussed recent changes to Regulation D effected by the Dodd-Frank Act, taught about Regulation A, staying private, Rule 701, Rule 144 and tacking issues, Section 4 (1-1/2) transactions, block trades, and financings in close proximity to one another.

David Kaufman participated in the April 17, 2012 Swap Dealer Registration and Compliance Working Session seminar to review the process for swap dealer registration, with a focus on the compliance policies and procedures that will be required in connection with registration. The seminar discussed business conduct standards, anti-manipulation and other related matters.

Bruce Mann and Anna Pinedo participated in a panel titled “Teleconference: How will the JOBS Act Affect Non-U.S. Issuers?” on April 17, 2012. Panelists focused on the practical implications for Israeli companies, whether or not they qualify as “foreign private issuers” contemplating an IPO, as well as for Israel-based issuers that may want to conduct a private placement or Rule 144A offering and target U.S. investors.

On April 24, 2012, MoFo partners Peter Green, Jeremy Jennings-Mares and Lloyd Harmetz spoke on the West Legalworks Webinar titled “Structured Products: Update Recent US and EU Regulatory Developments.” This program provided

an update as to recent developments impacting structured product development and sales in the US and Europe, based on recent regulatory initiatives from the SEC, FINRA, European Commission, ESMA and the FSA.

Well-known investment banker William Hambrecht and MoFo partners David Lynn and Anna Pinedo joined an April 24, 2012 webinar titled “Dealflow Media Webinar: Jumpstarting the Markets – How the JOBS Act will Affect Capital Raising for Emerging Companies” that taught how the JOBS Act will affect all aspects of capital raising for emerging companies.

MoFo partners David Lynn and Anna Pinedo joined the PLI Global Capital Markets & the U.S. Securities Laws 2012 program on “Raising Capital in an Evolving Regulatory Environment” on April 25, 2012. This program is designed to keep securities lawyers up-to-date on domestic and international regulatory and market developments, bringing together an engaging group of expert practitioners and senior regulators for an in-depth look at how the U.S. securities laws work in the context of a rapidly evolving global regulatory environment.

MoFo partners Anna Pinedo and Hillel Cohn participated in the FMA’s 2012 Securities Compliance Seminar on Cross-Border Concerns: Inbound and Outbound on April 25, 2012. The Seminar’s goal is to help participants acquire an understanding (as well as tools for dealing with) the challenges and regulatory “hot button” priorities currently facing compliance professionals, risk managers and internal auditors in the bank-affiliated broker-dealer industry. The focus was on current compliance topics, new rules or interpretations and regulatory developments, including a Dodd-Frank regulatory reform update. Attendees were given the opportunity to sharpen their skills through general workshop and interactive sessions with their peers, industry leaders and regulators.

The IFLR European Capital Markets Forum, on April 25-26, 2012, brought together high profile speakers from banks, funds, regulators and law firms, including

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MoFo partner Dwight Smith, to discuss and inform on these essential topics.

MoFo partner Anna Pinedo spoke on the Alternatives to Traditional Securitization Channels Panel during the May 6-9, 2012 Mortgage Bankers Association: National Secondary Market Conference and Expo. This session specifically focused on alternative securitization channels including REITs, covered bonds and life insurance companies in the marketplace. Issues discussed included the Dodd-Frank Act, SEC Concept Release, risk retention and more. Attendees had an opportunity to discuss several aspects of risk management and policy directions as they pertain to today's business climate.

Jerry Marlatt spoke at the May 10, 2012 ICMA Covered Bond Investor Conference. Speakers and panelists representing regulators, issuers, intermediaries and other interested parties were invited to participate on the basis of what they can contribute to the debate and independent of any sponsorship.

Investment banker William Hambrecht and MoFo partners Anna Pinedo and James Tanenbaum spoke on a May 10, 2012 panel titled "Smaller Public Offerings: Stepping Stone to IPO, or IPO Alternative?" The Jumpstart Our Business Startups (JOBS) Act was passed by the U.S. Congress and signed into law by President Obama. The JOBS Act represents the most significant change to our capital formation regulatory framework since Securities Offering Reform in 2005 and permits non-reporting companies to conduct "mini" public offerings, or Regulation A/3(b)

(2) exempt offerings. The panelists discussed this capital raising alternative.

On May 16, 2012, MoFo partners John Delaney, David Lynn and Anna Pinedo joined a panel titled "Teleconference: Crowdfunding Offerings." Panelists focused on the crowdfunding provisions included in the JOBS Act, and the practical implications for issuers that may wish to consider crowdfunding, and the considerations for intermediaries that may advise in connection with crowdfunding offerings.

A speaker panel from Protiviti and Morrison & Foerster on May 22, 2012, titled "Protiviti Webinar: Issues to Consider when Preparing Capital Plans and Stress Testing" provided an overview of the most important regulatory developments related to capital and provides practical insights into what financial institutions should do when preparing for Capital Plans and Stress Testing. MoFo partners Charles Horn and Dwight Smith joined the panel.

MoFo partner Anna Pinedo participated in the May 22, 2012 Practical Law Company Webinar, "How Will the JOBS Act Affect Non-US Issuers," which focused on the practical implications of the JOBS Act for foreign issuers, whether contemplating an IPO, private placement or Rule 144A offering targeting US investors.

MoFo partners David Kaufman and Anna Pinedo participated in a British Bankers' Association workshop titled "Swap Dealer Registration and Compliance Workshop" on May 23, 2012. This breakfast workshop was run by Morrison & Foerster and was a working session to review with foreign banks the final rules establishing the process for registering swap dealers and major swap participants. It also examined the business conduct standards applicable

to swap dealers, the compliance policies and procedures required for participants in the derivatives market, recordkeeping and reporting requirements and related developments arising in connection with the Dodd-Frank Act.

MoFo partners David Lynn and Randall Fons joined the May 30, 2012 PLI Program titled "JOBS Act 2012." This comprehensive program covered important changes and issues raised by the JOBS Act that impact not only securities and corporate lawyers, but emerging growth company executives, litigators and research analysts as well. Meredith B. Cross, Director, Division of Corporation Finance and Robert W. Cook, Director, Division of Trading and Markets with the Securities and Exchange Commission, participated as well.

MoFo partner Rimmelt Reigersman joined a June 14, 2012 panel titled "Practical Issues in Implementing Section 871(m)" at the 27th Annual Spring Tax Day presented by the Committee of Banking Institutions on Taxation.

Fordham Law School and Morrison & Foerster will host a seminar on July 17, 2012 to discuss recent developments in U.S. Law. Panels will include: Overview of the Dodd Frank Act and Dodd Frank Status Report, Understanding the Territorial Impact of the Volcker Rule, The Interrelationship of Basel III and the Dodd Frank Act, Capital Raising Alternatives for Foreign Issuers According to the U.S. Market.

About Morrison & Foerster

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