Treatment of Taxes in Credit Agreements

An analysis of the LSTA Model Credit Agreement Provisions

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October 8, 2012

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INTRODUCTION

In August 2011, the Primary Market Committee of the Loan Syndications and Trading Association (LSTA) published revised Model Credit Agreement Provisions (MCAPs), which were subsequently revised in August 2012. The drafters of the MCAPs addressed taxes by dividing their treatment into two categories:

1. Taxes on payments (withholding)
2. Taxes on everything else

This division is consistent with the philosophy of yield protection since there are two basic ways that taxes can affect a lender's return. First, tax rules can affect the amount of each payment from the borrower to the lender; is the borrower required to withhold any amount from the payment? Second, when a lender receives a payment, tax rules will affect how much of it the lender can actually keep; a portion of each payment may be paid to the government in the form of income taxes, for example.

Taxes on payments[1] usually apply to cross-border payments. The United States, for example, imposes 30% withholding on interest paid by a U.S. borrower to a non-U.S. lender, subject to certain statutory and treaty exceptions. Foreign borrowers often are subject to similar rules in their home jurisdictions when borrowing funds from U.S. lenders. These taxes on payments are governed by the Taxes Section of the MCAPs.[2] That section and the related definitions will determine whether the lender is made whole for any taxes on payments.

Compensation for any other kind of tax is governed by the Increased Costs Section of the MCAPs.[3] For a lender to be compensated for taxes under the Increased Costs Section, the tax would have to be imposed as a result of a change in law and the tax could not be an excluded tax or a tax covered by the Taxes Section. For example, a change in law that imposes additional withholding (that is, a new tax on payment) would be subject to the Taxes Section and would not be subject to the Increased Costs Section, even though the new tax is the result of a change in law. As further explained below, it is a very narrow kind of tax aimed specifically at banks that may be covered by the Increased Costs Section.

[1] The LSTA presenters and commentators use the term "taxes on payments." These materials adopt that terminology but also use the term "withholding." Withholding is not necessarily a tax. It is a method of collection. In general, withholding rules require the party in control of funds to hold back a certain amount before paying the funds over to a party that may otherwise be outside the taxing jurisdiction. The payee may not ultimately be subject to a tax and may get the withheld funds back through a refund request. Withholding is just an efficient means for a tax authority to ensure payment.
[2] MCAPs, Yield Protection, Section 2.
[3] MCAPs, Yield Protection, Section 1.

DEFINITIONS

Excluded Taxes[1]

LSTA	Plain English
(a) Taxes imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case, (i) imposed as a result of such Recipient being organized under the laws of, or having its principal office or, in the case of any Lender, its applicable lending office located in, the jurisdiction imposing such Tax (or any political subdivision thereof) or (ii) that are Other Connection Taxes	(a) net income[2] franchise Taxes, and branch profits Taxes imposed due to lender's connection to the jurisdiction (i.e., Connection Income Taxes)
(b) in the case of a Lender, U.S. federal withholding Taxes imposed on amounts payable to or for the account of such Lender with respect to an applicable interest in a Loan or Commitment pursuant to a law in effect on the date on which (i) such Lender acquires such interest in the Loan or Commitment (other than pursuant to an assignment request by the Borrower under Section [Replacement of Lenders]) or (ii) such Lender changes its lending office, except in each case to the extent that, pursuant to Section [Taxes], amounts with respect to such Taxes were payable either to such Lender's assignor immediately before such Lender became a party hereto or to such Lender immediately before it changed its lending office	(b) Day 1 Withholding[3]
(c) Taxes attributable to such Recipient's failure to comply with Section [Taxes – Status of Lenders] and (d) any U.S. federal withholding Taxes imposed under FATCA.	(c) Forms failure taxes[4]
(d) any U.S. federal withholding Taxes imposed under FATCA.	(d) FATCA

Notes:

1. This is an important definition. A lender will never be compensated for any Excluded Taxes.

2. The first prong is limited to net income. This is important. See discussion of borrower comments beginning on page 4 and the discussion of Increased Costs beginning on page 20.

3. Withholding known to apply at the time the loan is made usually is excluded, but any withholding resulting from future changes in law is not. Lenders usually can manage around day one withholding by qualifying for an exemption, not making the loan at all or just accepting the withholding. On the other hand, accounting for the risk of future withholding would require higher interest rates, so borrowers generally accept that risk.

4. Lenders generally accept prongs (c) and (d) because these taxes generally apply only if the lender has failed to act.

Excluded Taxes (cont.)

"Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes ~~imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case~~,[1] (i) imposed as a result of such Recipient being organized under the laws of, or having its principal office or, in the case of any Lender, its applicable lending office located in, the jurisdiction imposing such Tax (or any political subdivision thereof) or (ii) that are Other Connection Taxes, (b) in the case of a Lender, ~~U.S. federal~~[2] withholding Taxes imposed on amounts payable to or for the account of such Lender with respect to an applicable interest in a Loan or Commitment pursuant to a law in effect on the date on which (i) such Lender acquires such interest in the Loan or Commitment (other than pursuant to an assignment request by the Borrower under Section [Replacement of Lenders]) or (ii) such Lender changes its lending office, except in each case to the extent that, pursuant to Section [Taxes], amounts with respect to such Taxes were payable either to such Lender's assignor immediately before such Lender became a party hereto or to such Lender immediately before it changed its lending office, (c) Taxes attributable to such Recipient's failure to comply with Section [Taxes – Status of Lenders] and (d) any U.S. federal withholding Taxes imposed under FATCA.

"Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes imposed on **assets, capital or liabilities**, **or imposed on** or measured by net income (however denominated), **gross income, gross receipts, profits, gross profits**, franchise Taxes, and branch profits Taxes, in each case, . . . [3]

Notes:

1. We expect borrowers to argue that any connection taxes – not just net income, franchise or branch profits taxes – should be Excluded Taxes. The basis for the argument is that the lender controls where it has a connection; so, if a tax is due to a connection, it should not matter what type of tax it is.

   We resist this change for a number of reasons, including that it simply is not customary. Only 8 of the 44 publicly-filed credit agreements we reviewed expand this exclusion beyond the LSTA formulation. See Current Market Treatment beginning on page 25.

2. We expect to see this deletion any time there is a foreign borrower. The withholding rules of the foreign borrower's tax jurisdiction are the more relevant rules for the foreign borrower. Without this change, only day one U.S. withholding taxes would be Excluded Taxes. In other words, without this change, the foreign borrower would be subject to the

gross up requirement if it is subject to non-U.S. withholding rules, even if those rules exist on day one.

Whether this change is appropriate depends on the facts and circumstances. In some cases, it is not difficult to qualify for an exemption from the non-U.S. withholding rules and so the deletion is not a burden to lenders. In other cases, it may be appropriate for the borrower to bear the additional cost in order to obtain the loan.

3. This change attempts to capture by addition the same thing that the change discussed in Note 1 captures by subtraction. A borrower might be trying to exclude all connection taxes or it might be aiming specifically for bank taxes. See the discussion beginning on page 20 regarding Increased Costs.

FATCA

"FATCA" means Sections 1471 through 1474 of the Code, **as amended from time to time** ~~as of the date of this Agreement (or any amended version that is substantively comparable and not materially more onerous to comply with)~~,[1] any current or future regulations or official interpretations thereof and any agreements entered into pursuant to Section 1471(b)(1) of the Code.[2]

Notes:

1. Borrowers often propose changes similar to those noted above, although the LSTA formulation seems to be accepted more frequently now without comment. In August 2011, when the new MCAPs were published, FATCA was still very much in flux. The LSTA language, although it is vague, was the best compromise the LSTA could devise to account for future changes while protecting lenders against the adverse consequences of any drastic changes to the rules. We insist on the LSTA formulation because FATCA is still unsettled.

2. In the U.S. market it is customary to allocate FATCA risks to the lenders. (As noted above in the discussion of the definition of Excluded Taxes, taxes imposed under FATCA are Excluded Taxes.) However, given that FATCA more directly affects foreign financial institutions, the European market has not adopted the U.S. approach. In fact, the Loan Market Association remains officially non-committal on the issue and has published two FATCA riders for use by its constituents: one that allocates FATCA risks to lenders and another that allocates FATCA risks to borrowers.

Foreign Account Tax Compliance Act (FATCA)
Brief Overview and Update

FATCA is a reporting and withholding regime designed to force foreign financial institutions (FFIs) to assist the Treasury Department and the IRS in obtaining information on offshore accounts held by U.S. persons.

FATCA imposes a 30% withholding tax on "withholdable payments" (e.g., interest) made to a foreign financial institution (and certain other foreign organizations), unless the foreign financial institution agrees to provide the IRS information regarding its U.S. accounts. The rules are still evolving, but there will be several ways a foreign institution will be able to comply with FATCA and avoid withholding.

FATCA is an additional withholding regime that applies separate and apart from the normal withholding rules. A foreign lender may be entitled to treaty benefits and may provide the appropriate form that demonstrates that it is not subject to the general withholding rule that requires 30% withholding on payments to foreign lenders. But the lender may still be subject to FATCA withholding if it has not also complied with FATCA.

FATCA is relevant for U.S. borrowers and U.S. administrative agents. The MCAPs recognize that the administrative agent often will be the withholding agent. Lenders serving as administrative agent should be prepared to: (1) provide documentation to the borrower to avoid FATCA withholding on payments from the borrower to the administrative agent and (2) withhold on payments to any lender that has not provided the required documentation to the administrative agent regarding FATCA compliance.

Important Dates

Certain obligations outstanding on January 1, 2013 are grandfathered, unless materially modified.

FATCA withholding is scheduled to apply:

- to Withholdable Payments that are U.S. source dividends, interest and other fixed income payments made on or after **January 1, 2014**.
- Withholdable Payments that are payments of U.S. source gross proceeds made on or after January 1, 2015.
- Passthru Payments that are Withholdable Payments made to account holders or other FFIs that do not comply with FATCA are subject to withholding beginning January 1, 2014.
- Foreign Passthru Payments (generally, the portion of a payment made by an FFI that is deemed attributable to such FFI's U.S. assets) made to account holders or other FFIs that do not comply with FATCA are subject to withholding beginning no earlier than January 1, 2017 (although an FFI is required to report with respect to such Foreign Passthru Payments beginning January 1, 2015).

Indemnified Taxes

"Indemnified Taxes" means (a) Taxes, other than Excluded Taxes~~, imposed on or with respect to any payment made by or on account of any obligation of [the Borrower] [any Loan Party] under any Loan Document~~[1] and (b) to the extent not otherwise described in (a), Other Taxes.

Notes:

1. Sometimes we find credit agreements that are a mix of the new MCAPs and the previous model. The new MCAPs are designed so that all taxes on payments are addressed in the Taxes Section. The system breaks down, possibly in the lender's favor, when the definition of Indemnified Taxes looks like the one above.

Other Defined Terms

"Connection Income Taxes" means Other Connection Taxes that are imposed on or measured by net income (however denominated) or that are franchise Taxes or branch profits Taxes.

> **Notes**: See discussion of Increased Costs beginning on page 20.

"Other Connection Taxes" means, with respect to any Recipient, Taxes imposed as a result of a present or former connection between such Recipient and the jurisdiction imposing such Tax (other than connections arising from such Recipient having executed, delivered, become a party to, performed its obligations under, received payments under, received or perfected a security interest under, engaged in any other transaction pursuant to or enforced any Loan Document, or sold or assigned an interest in any Loan or Loan Document).

> **Notes**: This definition was added in the most recent update of the MCAPs. The result is to expand the first prong of Excluded Taxes to cover connection taxes based on any connection and not just a physical presence.

"Other Taxes" means all present or future stamp, court or documentary, intangible, recording, filing or similar Taxes that arise from any payment made under, from the execution, delivery, performance, enforcement or registration of, from the receipt or perfection of a security interest under, or otherwise with respect to, any Loan Document, except any such Taxes that are Other Connection Taxes imposed with respect to an assignment (other than an assignment made pursuant to Section [Mitigation Obligations; Replacement of Lenders – Replacement of Lenders]).

"Taxes" means all present or future taxes, levies, imposts, duties, deductions, withholdings (including backup withholding), assessments, fees or other charges imposed by any Governmental Authority, including any interest, additions to tax or penalties applicable thereto.

Taxes

Payments Free of Taxes (Tax Gross-Up)

(b) Payments Free of Taxes. Any and all payments by or on account of any obligation of [the Borrower] [any Loan Party] under any Loan Document shall be made without deduction or withholding for any Taxes, except as required by applicable law.[1] If any applicable law (as determined in the good faith discretion of an applicable Withholding Agent) requires the deduction or withholding of any Tax from any such payment by a Withholding Agent, then the applicable Withholding Agent shall be entitled to make such deduction or withholding and shall timely pay the full amount deducted or withheld to the relevant Governmental Authority in accordance with applicable law[2] and, if such Tax is an Indemnified Tax, then the sum payable by [the Borrower] [the applicable Loan Party] shall be increased as necessary so that after such deduction or withholding has been made (including such deductions and withholdings applicable to additional sums payable under this Section) the applicable Recipient receives an amount equal to the sum it would have received had no such deduction or withholding been made.[3]

Notes:

1. The first sentence establishes the general rule that payments are required to be made without deduction, unless withholding is required by law.

2. If withholding is required, the withholding agent (the borrower or the administrative agent) is entitled to withhold the required amount.

3. However, if the amount withheld is an Indemnified Tax (i.e., a tax on a payment that is not an Excluded Tax), then the payor must gross up the amount of the payment to the amount that would have been paid had there been no withholding.

   A gross up usually requires more than simple addition because the gross up itself often is subject to withholding. For example, assume that the required interest payment is $100 and assume that a 15% withholding rate applies. If the borrower makes a net payment to the lender of $85 and pays over an additional $15 to offset the amount withheld and paid to the tax authority, the lender will not be made whole. The borrower would be required to withhold 15% from the additional $15 payment, so the net payment to the lender would be $97.75 ($85 + $12.75).

   The net payment to the lender needs to be $100. To successfully gross up the payment so that the lender is not affected by the 15% withholding, the borrower would have to make a gross payment of $117.64. The borrower would withhold and pay to the government 15% ($17.64) and the lender would receive a net payment of $100.

Payment of Other Taxes by the Borrower

(c) Payment of Other Taxes by the Borrower. [The Borrower] [The Loan Parties] shall timely pay to the relevant Governmental Authority in accordance with applicable law, or at the option of the Administrative Agent timely reimburse it for the payment of, any Other Taxes.[1]

Notes:

1. Other Taxes are documentary, stamp, registration and similar taxes. In some cases, the borrower is required to pay the tax directly. In other cases, the administrative agent may pay the tax and seek reimbursement. This is the kind of expense that has always been passed on to borrowers, so this provision typically is not controversial.

Indemnification by the Borrower

(d) Indemnification by the Borrower. [The Borrower] [The Loan Parties] shall [jointly and severally] indemnify each Recipient, within 10 days after demand therefor, for the full amount of any Indemnified Taxes (~~including Indemnified Taxes imposed or asserted on or attributable to amounts payable under this Section~~)[1] payable or paid by such Recipient or required to be withheld or deducted from a payment to such Recipient and any reasonable expenses arising therefrom or with respect thereto, whether or not such Indemnified Taxes were correctly or legally imposed or asserted by the relevant Governmental Authority. A certificate as to the amount of such payment or liability delivered to the Borrower by a Lender (with a copy to the Administrative Agent), or by the Administrative Agent on its own behalf or on behalf of a Lender, shall be conclusive absent manifest error.

Notes:

1. This provision is the back-stop to the tax gross up in subsection (b). It indemnifies the lender for indemnified taxes that the lender paid directly, as well as indemnified taxes that were not grossed up or that were inadequately grossed up.

   This section usually is not controversial, although we have received minor push back on the parenthetical in the first sentence, with some borrowers proposing the deletion reflected above. The parenthetical provides indemnification for any tax applicable to an indemnification payment. For example, a borrower may be subject to a withholding rule that applies to any payment made to the lender. Under this rule, the borrower may be forced to withhold from both the interest payment and the related gross up or indemnification payment that compensates the lender for the original withholding. The lender should be made whole in both cases.

Robinson Bradshaw

Indemnification by the Lenders[1]

(e) Indemnification by the Lenders. Each Lender shall severally indemnify the Administrative Agent, within 10 days after demand therefor, for (i) any Indemnified Taxes attributable to such Lender (but only to the extent that [the Borrower] [any Loan Party] has not already indemnified the Administrative Agent for such Indemnified Taxes and without limiting the obligation of [the Borrower] [the Loan Parties] to do so), (ii) any Taxes attributable to such Lender's failure to comply with the provisions of Section [Successors and Assigns – Participations] relating to the maintenance of a Participant Register[2] and (iii) any Excluded Taxes attributable to such Lender, in each case, that are payable or paid by the Administrative Agent in connection with any Loan Document, and any reasonable expenses arising therefrom or with respect thereto, whether or not such Taxes were correctly or legally imposed or asserted by the relevant Governmental Authority. A certificate as to the amount of such payment or liability delivered to any Lender by the Administrative Agent shall be conclusive absent manifest error. Each Lender hereby authorizes the Administrative Agent to set off and apply any and all amounts at any time owing to such Lender under any Loan Document or otherwise payable by the Administrative Agent to the Lender from any other source against any amount due to the Administrative Agent under this paragraph (e).

Notes:

1. This section usually is not controversial. It is an appropriate complement to subsection (d) that protects the administrative agent when it acts as withholding agent.

   The MCAPs, in this section and in the forms requirements in section (g), now recognize that the administrative agent, rather than the borrower, likely will be the withholding agent under U.S. tax rules. A withholding agent is any person having the control, receipt, custody, disposal, or payment of any specific items of income, such as U.S. source interest, payable to certain foreign payees. For a loan to a U.S. borrower by a lending group that includes foreign lenders, the administrative agent will be the party that disburses funds to the foreign lenders. It will be incumbent upon the administrative agent to withhold on payments to foreign lenders that have not provided the required exemption certificate or are otherwise subject to withholding.

2. Certain tax rules, such as the exemption from withholding applicable to portfolio interest, require that debt be in registered form. To satisfy this requirement, administrative agents traditionally have maintained a register for assignments. Credit parties became concerned that participations may require registration because they could be treated as beneficial ownership interests in the underlying loan for U.S. tax purposes. In order to address this concern, lenders are now required to maintain a register of their participations.

Evidence of Payments

(f) Evidence of Payments. As soon as practicable after any payment of Taxes by [the Borrower] [any Loan Party] to a Governmental Authority pursuant to this Section [Taxes], [the Borrower] [such Loan Party] shall deliver to the Administrative Agent ~~the original or a certified copy of a receipt issued by such Governmental Authority evidencing such payment, a copy of the return reporting such payment or other~~[1] evidence of such payment reasonably satisfactory to the Administrative Agent.

Notes:

1. Lenders should not accept this proposed change. Sometimes borrowers do not want to commit in advance to submitting originals or certified copies. They will argue that it can be difficult to obtain such documentation from the government authorities, and that often it is unreasonably burdensome to pursue such documentation for payments that may be immaterial in amount. A lender, of course, may have the burden of proving that the taxes for which it is liable have been paid. A lender needs to substantiate the payment with the best evidence possible.

Status of Lenders[1]

(g) Status of Lenders.

(i) Any Lender that is entitled to an exemption from or reduction of withholding Tax with respect to payments made under any Loan Document shall deliver to the Borrower and the Administrative Agent, at the time or times reasonably requested by the Borrower or the Administrative Agent, such properly completed and executed documentation reasonably requested by the Borrower or the Administrative Agent as will permit such payments to be made without withholding or at a reduced rate of withholding. In addition, any Lender, if reasonably requested by the Borrower or the Administrative Agent, shall deliver such other documentation prescribed by applicable law or reasonably requested by the Borrower or the Administrative Agent as will enable the Borrower or the Administrative Agent to determine whether or not such Lender is subject to backup withholding or information reporting requirements. ~~Notwithstanding anything to the contrary in the preceding two sentences, the completion, execution and submission of such documentation (other than such documentation set forth in Section [Taxes — Status of Lenders] (ii)(A), (ii)(B) and (ii)(D) below) shall not be required if in the Lender's reasonable judgment such completion, execution or submission would subject such Lender to any material unreimbursed cost or expense or would materially prejudice the legal or commercial position of such Lender.~~[2]

(ii) Without limiting the generality of the foregoing, in the event that the Borrower is a U.S. Borrower,[3]

(A) any Lender that is a U.S. Person shall deliver to the Borrower and the Administrative Agent on or prior to the date on which such Lender becomes a Lender under this Agreement (and from time to time thereafter upon the reasonable request of the Borrower or the Administrative Agent), executed originals of IRS Form W-9 certifying that such Lender is exempt from U.S. federal backup withholding tax;[4]

(B) any Foreign Lender shall, to the extent it is legally entitled to do so, deliver to the Borrower and the Administrative Agent (in such number of copies as shall be requested by the recipient) on or prior to the date on which such Foreign Lender becomes a Lender under this Agreement (and from time to time thereafter upon the reasonable request of the Borrower or the Administrative Agent), whichever of the following is applicable:

(i) in the case of a Foreign Lender claiming the benefits of an income tax treaty to which the United States is a party (x) with respect to payments of interest under any Loan Document, executed originals of IRS Form W-8BEN establishing an exemption from, or reduction of, U.S. federal withholding Tax pursuant to the "interest" article of such tax treaty and (y) with respect to any other applicable payments under any Loan Document, IRS Form W-8BEN establishing an exemption from, or reduction of, U.S. federal withholding Tax pursuant to the "business profits" or "other income" article of such tax treaty;

(ii) executed originals of IRS Form W-8ECI;

(iii) in the case of a Foreign Lender claiming the benefits of the exemption for portfolio interest under Section 881(c) of the Code, (x) a certificate substantially in the form of Exhibit [J]-1 to the effect that such Foreign Lender is not a "bank" within the meaning of Section 881(c)(3)(A) of the Code, a "10 percent shareholder" of the Borrower within the meaning of Section 881(c)(3)(B) of the Code, or a "controlled foreign corporation" described in Section 881(c)(3)(C) of the Code (a "U.S. Tax Compliance Certificate") and (y) executed originals of IRS Form W-8BEN; or

(iv) to the extent a Foreign Lender is not the beneficial owner, executed originals of IRS Form W-8IMY, accompanied by IRS Form W-8ECI, IRS Form W-8BEN, a U.S. Tax Compliance Certificate substantially in the form of Exhibit [J]-2 or Exhibit [J]-3, IRS Form W-9, and/or other certification documents from each beneficial owner, as applicable; provided that if the Foreign Lender is a partnership and one or more direct or indirect partners of such Foreign Lender are claiming the portfolio interest exemption, such Foreign Lender may provide a U.S. Tax Compliance Certificate substantially in the form of Exhibit [J]-4 on behalf of each such direct and indirect partner;

(C) any Foreign Lender shall, to the extent it is legally entitled to do so, deliver to the Borrower and the Administrative Agent (in such number of copies as shall be requested by the recipient) on or prior to the date on which such Foreign Lender becomes a Lender under this Agreement (and from time to time thereafter upon the reasonable request of the Borrower or the Administrative Agent), executed originals of any other form prescribed by applicable law as a basis for claiming exemption from or a reduction in U.S. federal withholding Tax, duly completed, together with such supplementary documentation as may be prescribed by applicable law to permit the Borrower or the Administrative Agent to determine the withholding or deduction required to be made; and

(D) if a payment made to a Lender under any Loan Document would be subject to U.S. federal withholding Tax imposed by FATCA if such Lender were to fail to comply with the applicable reporting requirements of FATCA (including those contained in Section 1471(b) or 1472(b) of the Code, as applicable), such Lender shall deliver to the Borrower and the Administrative Agent at the time or times prescribed by law and at such time or times reasonably requested by the Borrower or the Administrative Agent such documentation prescribed by applicable law (including as prescribed by Section 1471(b)(3)(C)(i) of the Code) and such additional documentation reasonably requested by the Borrower or the Administrative Agent as may be necessary for the Borrower and the Administrative Agent to comply with their obligations under FATCA and to determine that such Lender has complied with such Lender's obligations under FATCA or to determine the amount to deduct and withhold from such payment. Solely for purposes of this clause (D), "FATCA" shall include any amendments made to FATCA after the date of this Agreement.[5]

Each Lender agrees that if any form or certification it previously delivered expires or becomes obsolete or inaccurate in any respect, it shall update such form or certification or promptly notify the Borrower and the Administrative Agent in writing of its legal inability to do so.

Notes:

1. The United States imposes 30% withholding on interest paid by a U.S. borrower to a non-U.S. lender, subject to certain statutory and treaty exceptions. The payee usually is required to prove that it is eligible for one of the exceptions. This section simply incorporates into the credit agreement the existing obligation to provide the appropriate forms. Pursuant to the definition of Excluded Taxes, a lender will not be compensated for any taxes imposed as a result of a failure to provide the forms required under this section.

2. Borrowers sometimes propose deleting the marked language. They complain that it is vague and that it gives lenders too much discretion. In fact, it does not. The parenthetical in the deleted language — *(other than such documentation set forth in Section [Taxes—Status of Lenders] (ii)(A), (ii)(B) and (ii)(D) below)* — is a carve out. Under no circumstances can the lender get out of providing the forms required by (A), (B) and (D). Those sections cover all of the important forms. It would be a strange documentation requirement that causes the lender to invoke the protection provided by the deleted language, and lenders should be protected from unusual or non-customary documentation requirements with potentially adverse consequences.

3. The IRS has adopted various forms and certificates for the purpose for substantiating statutory and treaty exemptions. The MCAPs specifically identify the applicable forms. This drafting approach has the benefit of educating foreign lenders who may not be familiar with the required forms, but since the forms and their titles change, it also carries the risk of becoming out of date. Occasionally, a borrower, as a drafting preference, will propose more generic language that simply requires the provision of all forms required by applicable law. Under the right circumstances, we will accept that change.

4. When there is a U.S. borrower and a U.S. lender, whether there are any taxes on payments comes down to this basic W-9 requirement. Unless the lender fails to provide a W-9 or is in fact subject to backup withholding, there should be no taxes on payments and the Taxes Section should be less important.

5. Solely for purposes of the documentation requirement, the defined term "FATCA" includes all future amendments, not just those that are "substantively comparable and not materially more onerous to comply with."

Treatment of Certain Refunds

(h) Treatment of Certain Refunds. If any party determines, in its sole discretion exercised in good faith, that it has received a refund of any Taxes **(including any tax credit in lieu of a refund)**[1] as to which it has been indemnified pursuant to this Section [Taxes] (including by the payment of additional amounts pursuant to this Section [Taxes]), it shall pay to the indemnifying party an amount equal to such refund (but only to the extent of indemnity payments made under this Section with respect to the Taxes giving rise to such refund), net of all out-of-pocket expenses (including Taxes) of such indemnified party and without interest (other than any interest paid by the relevant Governmental Authority with respect to such refund). Such indemnifying party, upon the request of such indemnified party, shall repay to such indemnified party the amount paid over pursuant to this paragraph (h) (plus any penalties, interest or other charges imposed by the relevant Governmental Authority) in the event that such indemnified party is required to repay such refund to such Governmental Authority. ~~Notwithstanding anything to the contrary in this paragraph (h), in no event will the indemnified party be required to pay any amount to an indemnifying party pursuant to this paragraph (h) the payment of which would place the indemnified party in a less favorable net after-Tax position than the indemnified party would have been in if the indemnification payments or additional amounts giving rise to such refund had never been paid.~~ [2] This paragraph shall not be construed to require any indemnified party to make available its Tax returns (or any other information relating to its Taxes that it deems confidential) to the indemnifying party or any other Person.[3]

Notes:

1. Borrowers sometimes comment that this provision should cover any credit against future tax liabilities that is received in lieu of a refund. But borrowers rarely win this argument. Only 4 of the 44 credit agreements we reviewed require lenders to share the economic benefit of a tax credit. See Current Market Treatment beginning on page 25.

2. Borrowers often object to this language as vague and too lender-friendly. The "fixed rate of return" argument is the best defense.

3. The revisions to the MCAPs published by the LSTA on August 1, 2012 included the following clarifications to this provision:

   " . . . Notwithstanding anything to the contrary in this paragraph (h), in no event will the indemnified party be required to pay any amount to an indemnifying party pursuant to this paragraph (h) the payment of which would place the indemnified party in a less favorable net after-Tax position than the indemnified party would have been in if the **Tax subject to indemnification and giving rise to such refund had not been deducted, withheld or otherwise imposed and the** indemnification payments or additional amounts ~~giving rise~~ **with respect** to such ~~refund~~ **Tax** had never been paid. . . ."

Increased Costs

(a) Increased Costs Generally. If any Change in Law shall:

(i) impose, modify or deem applicable any reserve, special deposit, compulsory loan, insurance charge or similar requirement against assets of, deposits with or for the account of, or credit extended or participated in by, any Lender (except any reserve requirement reflected in the Adjusted LIBO Rate) or any Issuing Bank;

(ii) subject any Recipient to any Taxes (other than (A) Indemnified Taxes, (B) Taxes described in clauses (b) through (d) of the definition of Excluded Taxes and (C) Connection Income Taxes) on its loans, loan principal, letters of credit, commitments, or other obligations, or its deposits, reserves, other liabilities or capital attributable thereto; or[1]

(iii) impose on any Lender or any Issuing Bank or the London interbank market any other condition, cost or expense (other than Taxes) affecting this Agreement or Loans made by such Lender or any Letter of Credit or participation therein;

and the result of any of the foregoing shall be to increase the cost to such Lender or such other Recipient of making, converting to, continuing or maintaining any Loan or of maintaining its obligation to make any such Loan, or to increase the cost to such Lender, such Issuing Bank or such other Recipient of participating in, issuing or maintaining any Letter of Credit (or of maintaining its obligation to participate in or to issue any Letter of Credit), or to reduce the amount of any sum received or receivable by such Lender, Issuing Bank or other Recipient hereunder (whether of principal, interest or any other amount) then, upon request of such Lender, Issuing Bank or other Recipient, the Borrower will pay to such Lender, Issuing Bank or other Recipient, as the case may be, such additional amount or amounts as will compensate such Lender, Issuing Bank or other Recipient, as the case may be, for such additional costs incurred or reduction suffered.

Notes:

1. Borrowers sometimes argue that all tax matters should be addressed in the Taxes Section. However, remember that the Taxes Section only applies to taxes on payments. The LSTA determined that there could be certain taxes imposed as a result of a change in law that are not taxes on payments and are not otherwise excluded taxes.

   The LSTA was concerned specifically with bank taxes, such as the UK Bank Levy, which became effective in January 2011 and subjects certain British financial institutions to an additional tax on the assets and liabilities on their balance sheets. Another example of a bank tax is the Financial Crisis Responsibility Fee in President Obama's recent budget proposals, which would require that U.S.-based financial institutions with worldwide consolidated assets of $50 billion or more pay a fee of 7.5 basis points on covered liabilities (adjusted risk-weighted assets). A lender would be compensated under the MCAPs if a bank tax, like the ones described above, is imposed as a result of a change in law. Under the MCAPs, this type of tax is similar to an increased cost due to a regulatory change that is appropriate to pass on to the borrower.

The MCAPs would not compensate a lender for a bank tax that exists when the loan is made – the Increased Costs Section applies only if there is a change in law and the Taxes Section applies only to taxes on payments. Also, a lender would not be compensated for a new bank tax that is based on net income, because such taxes are categorically excluded in the definition of Excluded Taxes. The kinds of bank taxes that would not be excluded are ones like the UK tax and the financial crisis responsibility fee that are asset or other balance sheet-based taxes.

One justification for compensating lenders for such balance-sheet based bank taxes is that it is possible to quantify the portion of the taxes allocable to a particular loan transaction. Even if it makes sense to pass a particular expense on to a borrower, the expense has to be reasonably determinable. One reason, among several, that lenders never pass on net income taxes is that it would be impossible to reasonably determine what portion of the tax should be borne by each borrower. A net income tax could be attributable to any number of other business activities. With a balance sheet-based tax, on the other hand, the parties should be able to objectively determine what portion of the tax is attributable to a particular loan made to a particular borrower.

Understanding the cross references in Section 1(a)(ii)

The strange cross-references in (a)(ii) of the Increased Costs Section are about bank taxes. The Increased Costs Section provides that a lender is compensated for increased costs due to Taxes on loans other than:

(A) Indemnified Taxes;

(B) Taxes described in clauses (b) through (d) of the definition of Excluded Taxes;

and

(C) Connection Income Taxes

(Connection Income Taxes include Other Connection Taxes that are imposed on or measured by net income (however denominated) or that are franchise Taxes or branch profits Taxes).

Indemnified Taxes should be excluded from the Increased Costs Section because they are covered by the Taxes Section. It is reasonable to expect that all Excluded Taxes would be excluded, so what is the point of (B) and (C)?

Clauses (B) and (C) cover everything that is covered by "Excluded Taxes." In other words, (a)(ii) would have the same meaning if clauses (B) and (C) were replaced by the term "Excluded Taxes." However, the drafters of the MCAPs were concerned that if they used the defined term "Excluded Taxes" in (a)(ii) lenders might inadvertently foreclose their ability to be made whole for bank taxes by accepting changes to the definition of Excluded Taxes without making corresponding adjustments in the Increased Costs Section.

Recall that borrowers often want to exclude all connection taxes:

> "Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes ~~imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case,~~

> "Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes imposed on **assets, capital or liabilities**, **or imposed on** or measured by net income (however denominated), **gross income, gross receipts, profits, gross profits**, franchise Taxes, and branch profits Taxes, in each case, . . .

The Increased Costs Section is designed to accommodate either of these changes to the definition of Excluded Taxes while preserving the possibility that a lender could be made whole for bank taxes imposed as a result of a change in law.

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No change to either section	"Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case, (i) imposed as a result of such Recipient being organized under the laws of, or having its principal office or, in the case of any Lender, its applicable lending office located in, the jurisdiction imposing such Tax (or any political subdivision thereof) or (ii) that are Other Connection Taxes (a)(ii) subject any Recipient to any Taxes (other than (A) Indemnified Taxes, (B) Taxes described in clauses (b) through (d) of the definition of Excluded Taxes and (C) Connection Income Taxes) on its loans, loan principal, letters of credit, commitments, or other obligations, or its deposits, reserves, other liabilities or capital attributable thereto;	Okay. Lender could be made whole for bank taxes.
No change to Excluded Taxes but Increased Costs Section is changed	"Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case, (i) imposed as a result of such Recipient being organized under the laws of, or having its principal office or, in the case of any Lender, its applicable lending office located in, the jurisdiction imposing such Tax (or any political subdivision thereof) or (ii) that are Other Connection Taxes (a)(ii) subject any Recipient to any Taxes (other than ~~(A)~~ Indemnified Taxes~~, (B) Taxes described in clauses (b) through (d) of the definition of~~ **and** Excluded Taxes ~~and (C) Connection Income Taxes~~) on its loans, loan principal, letters of credit, commitments, or other obligations, or its deposits, reserves, other liabilities or capital attributable thereto;	Okay. Lender could be made whole for bank taxes

Robinson Bradshaw

Change to Excluded Taxes, but no change to Increased Costs	"Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes ~~imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case,~~ (i) imposed as a result of such Recipient being organized under the laws of, or having its principal office or, in the case of any Lender, its Lending Office located in, the jurisdiction imposing such Tax (or any political subdivision thereof) or (ii) that are Other Connection Taxes, "Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes imposed on **assets, capital or liabilities, or imposed on** or measured by net income (however denominated), **gross income, gross receipts, profits, gross profits**, franchise Taxes, and branch profits Taxes, in each case, . . . (a)(ii) subject any Recipient to any Taxes (other than (A) Indemnified Taxes, (B) Taxes described in clauses (b) through (d) of the definition of Excluded Taxes and (C) Connection Income Taxes) on its loans, loan principal, letters of credit, commitments, or other obligations, or its deposits, reserves, other liabilities or capital attributable thereto;	Okay. Lender could be made whole for bank taxes
Changes to both Excluded Taxes and Increased Costs	"Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes ~~imposed on or measured by net income (however denominated), franchise Taxes, and branch profits Taxes, in each case,~~ (i) imposed as a result of such Recipient being organized under the laws of, or having its principal office or, in the case of any Lender, its Lending Office located in, the jurisdiction imposing such Tax (or any political subdivision thereof) or (ii) that are Other Connection Taxes, "Excluded Taxes" means any of the following Taxes imposed on or with respect to a Recipient or required to be withheld or deducted from a payment to a Recipient, (a) Taxes imposed on **assets, capital or liabilities, or imposed on** or measured by net income (however denominated), **gross income, gross receipts, profits, gross profits**, franchise Taxes, and branch profits Taxes, in each case, . . . (a)(ii) subject any Recipient to any Taxes (other than ~~(A)~~ Indemnified Taxes~~, (B) Taxes described in clauses (b) through (d) of the definition of~~ **and** Excluded Taxes ~~and (C) Connection Income Taxes~~) on its loans, loan principal, letters of credit, commitments, or other obligations, or its deposits, reserves, other liabilities or capital attributable thereto;	Not okay. Lender would not be made whole for bank taxes.

Current Market Treatment

We reviewed 44 publicly-available credit agreements that have closed since August 1, 2011

Day 1 Withholding Exclusion	**Percentage**
All Withholding	41%
U.S. Withholding only	52%
None	7%

Permits Increased Cost Reimbursement for Bank Taxes	**Percentage**
Yes	52%
No	48%

Borrower Reimbursed for Tax Credits as well as Refunds	**Percentage**
Yes	9%
No	91%

“Excluded Taxes” include more than Connection Income Taxes	**Percentage**
Yes	18%
No	82%

Definition of FATCA	**Percentage**
“as of the date hereof”	25%
as amended from time to time	14%
LSTA MCAP	52%
Not defined	9%

About the Presenters:

Seth Huffstetler is a shareholder of our firm and advises publicly and privately held companies regarding federal and state tax law matters, including the planning and execution of mergers, acquisitions and other transactions. He regularly assists clients with executive compensation tax matters, including compliance with Section 409A. Mr. Huffstetler also represents clients before the IRS in tax controversies and in the submission of private letter ruling requests.

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Jeffrey A. Henson serves as chair of our firm's lending practice group that in 2011 represented lenders and borrowers in credit transactions with an aggregate deal volume in excess of $19 billion. His practice focuses on a broad range of corporate finance matters, with a particular emphasis on the structuring and documenting of secured and unsecured lending transactions for both leveraged and investment-grade borrowers.

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