HUNTON & WILLIAMS

TAX CLIENT ALERT

May 2009

Obama Proposes New Rules for Equity Swaps and Forward Sales of Stock

On May 11, 2009, the U.S. Treasury released its *General Explanation of the Administration's Fiscal Year 2010 Revenue Proposals* (the "Revenue Proposals"). The Revenue Proposals include provisions that would impose withholding tax on equity swaps and securities lending transactions and that would require a corporation to accrue income on the forward sale of its stock.

Impose Withholding Tax on Equity Swaps and Securities Lending Transactions

The Revenue Proposals would treat income earned by foreign persons with respect to equity swaps referencing U.S. equities as U.S. source income to the extent that the income is attributable to (or calculated by reference to) dividends paid by a U.S. domestic corporation. Currently, payments made under a notional principal contract, such as an equity swap, are sourced to the residence of the investor, which means that under current law, dividend-equivalent payments made to a foreign investor under an equity swap are not subject to withholding tax.

This new sourcing rule would not apply to an equity swap if all of the following conditions are met:

- the terms of the equity swap do not require the foreign person to post more than 20% of the value of the underlying stock as collateral;
- the terms of the equity swap do not include provisions addressing the hedge position of the counterparty;
- the equity swap references underlying stock that is publicly traded;
- the equity swap has a notional amount that represents less than 5% of the total public float of that class of stock and less than 20% of the 30-day average daily trading volume;
- the foreign investor does not sell the stock to the counterparty at the inception of the contract, or buy the stock from the counterparty at the termination of the contract;
- the equity swap measures the parties' entitlements or obligations with respect to the value of the stock based on objectively observable prices; and
- the equity swap has a term of at least 90 days.

Under the Revenue Proposals, the Treasury would have the authority to create additional exceptions. The new sourcing rule would apply to payments made after December 31, 2010.

In addition to the change in sourcing for equity swaps included in the Revenue Proposals, the Treasury indicated that it planned to revoke Notice 97-66 relating to securities lending transactions and issue guidance that eliminates the benefit of such transactions but minimizes over-withholding.

Require Accrual of Income on Forward Sale of Corporate Stock

Currently, a corporation that sells its own stock currently in exchange for a deferred payment must accrue a portion of the payment as interest, but no interest accrual is currently required in the case of a forward sale. The Revenue Proposals would require a corporation that enters into a forward contract to sell its stock to treat currently a portion of the payment on the forward sale as a payment of interest. This proposal would be effective for forward contracts entered into after December 31, 2010.

The tax lawyers at Hunton & Williams LLP have extensive experience working with the U.S. Federal income tax aspects of derivative transactions and forward sales and are able to help you determine the impact of the Revenue Proposals on your business as well as aid you in planning for any restructuring that may be necessary.

Hunton & Williams Offices

Atlanta
Bank of America Plaza
Suite 4100
600 Peachtree Street, NE
Atlanta, Georgia 30308-2216
(404) 888-4000

Austin
111 Congress Avenue
Suite 1800
Austin, Texas 78701-4068
(512) 542-5000

Bangkok
34th Floor, Q.House Lumpini Building
1 South Sathorn Road
Thungmahamek, Sathorn
Bangkok 10120
Thailand
+66 2 645 88 00

Beijing
517-520 South Office Tower
Beijing Kerry Centre
No. 1 Guanghua Road
Chaoyang District
Beijing 100020
PRC
+86 10 5863 7500

Brussels
Park Atrium
Rue des Colonies 11
1000 Brussels, Belgium
+32 (0)2 643 58 00

Charlotte
Bank of America Plaza
Suite 3500
101 South Tryon Street
Charlotte, North Carolina 28280
(704) 378-4700

Dallas
1445 Ross Avenue
Suite 3700
Dallas, Texas 75202-2799
(214) 979-3000

Houston
Bank of America Center
Suite 4200
700 Louisiana Street
Houston, Texas 77002
(713) 229-5700

London
30 St Mary Axe
London EC3A 8EP
United Kingdom
+44 (0)20 7220 5700

Los Angeles
550 South Hope Street
Suite 2000
Los Angeles, CA 90071-2627
(213) 532-2000

McLean
1751 Pinnacle Drive
Suite 1700
McLean, Virginia 22102
(703) 714-7400

Miami
1111 Brickell Avenue
Suite 2500
Miami, Florida 33131
(305) 810-2500

New York
200 Park Avenue
New York, New York 10166-0091
(212) 309-1000

Norfolk
500 East Main Street
Suite 1000
Norfolk, Virginia 23510-3889
(757) 640-5300

Raleigh
One Bank of America Plaza
Suite 1400
421 Fayetteville Street
Raleigh, North Carolina 27601
(919) 899-3000

Richmond
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, Virginia 23219-4074
(804) 788-8200

San Francisco
575 Market Street
Suite 3700
San Francisco, California 94105
(415) 975-3700

Singapore
Samsung Hub
#29-04, 3 Church Street
Singapore 049483
+65 6876 6700

Washington
1900 K Street, NW
Washington, DC 20006-1109
(202) 955-1500

If you have any questions about the Revenue Proposals or other matters, please contact:

George C. Howell, III
(804) 788-8793
ghowell@hunton.com

B. Cary Tolley, III
(305) 810-2533
ctolley@hunton.com

Cecelia Philipps Horner
(804) 788-7394
chorner@hunton.com