

Tax Regulatory Reporting and Monitoring Solution

Mid- to Large-Sized Middle Market Syndicator

Duration: 6+ months

Overview

Phase I of the Foreign Account Tax Compliance Act (FATCA), also known as Chapter 4 of the IRS Code, became effective on July 1, 2014. This regulation placed obligations upon 'paying agents' to evaluate and potentially withhold on domestically-sourced fixed, determinable, annual, or periodic (FDAP) payments made to foreign entities.

The complexity of this IRS regulation for syndicated market administrative agents was compounded by the need to harmonize existing IRS Chapter 3 withholding and reporting processes with FATCA requirements, understanding the paying agent obligations in relation to syndication income, and system-of-record limitations in supporting the tax data validation, tracking, and reporting requirements.

Business Goals

Implement a system and process solution to:

1. Evaluate and process tax forms for payees in syndicated relationships agented by the client. In particular, the solution must be able to:
 - Determine source of income (i.e. borrower FDAP payments) is critical.
 - Evaluate the tax form provided by the payee for validity.
 - Anticipate complex payee corporate structure (i.e. W-8IMY entities with underlying entities), and the solution needs to be able to define that structure.
 - Account for heightened scrutiny on evaluation of domestic entities (W-9), particularly in relation to 1099 reporting (INT and MISC forms).
2. Record and track the validation of tax form data through the tax lifecycle.
3. Provide a suite of reports to identify or monitor the following:
 - Payee tax status (including pre-existing account and GIIN status).
 - Facility "grandfathered" status.
 - Withholding activity.
 - Year-end tax reporting data for all payees in syndicated deals agented by the client.

Business Challenges

Vendor Effectiveness

- The vendor of the system of record was simultaneously developing an enhancement to facilitate the potential mechanical withholding implications of FATCA, but did not devise a system to sufficiently track payee tax data or report on tax data.
- Due to the client's capital expenditure cycle, the ability to integrate the vendor's enhancement into the solution was not possible.

Limited Budget

- Due to budgetary and resource constraints, the options for the development of a solution, from a technology perspective, were limited.

Limited Regulatory Understanding

- There were very few resources within the industry that could provide expertise in interpreting FATCA regulation in relation to the syndicated loan market.
- It became quickly obvious that the LSTA needed to define a working group to support creating consensus around issues.

Timing

- Given the “go-live” date of the regulation, the solution had to be conceived, designed, developed, tested, and implemented within a short timeframe.

Value Proposition

Consulting and Project Management

- Ensuring client understanding of the impacts of the regulation in relation to syndicated loans and how those impacts might influence design of the solution.
- Coordinating implementation efforts, communication, and procedural development for operations staff.
- Ensuring completeness of testing and delivery of solution.

Solution Design

To support the client’s technology-related business requirements under resource and budgetary constraints, a relational database was designed.

Features of this database solution included:

- Storing manually-entered tax form data not captured by the client’s system of record. A complex text recognition solution was not possible, given the constraints of the client.
- A simple query against the system of record was developed to import lender information related to agent deals into a separate table within an external relational database. The manually-entered tax form data table was joined to the lender information table by a common customer ID key generated by the vendor system. As such the system of record information could be refreshed in the relational database (as lenders entered and exited the syndicated deal) without disrupting the tax form data.
- Additional logic was built into the relational database to account for tax form change or expiry as well as changing facility status.
- A suite of reports was designed for the purposes of tax data and facility status monitoring as well as provide tax data for year-end tax reporting (1042 and 1099).
- A simple translation table, to reside within the relational database, was also designed for the solution (though not implemented within the scope of the project) when it became apparent that the underlying two-digit reporting field code, as it relates to the tax form information, could likely be changed by the IRS from year to year.

Outcome

A simple yet elegant solution was designed for the client in an easily-accessible standard format that requires very little technical support or expertise. The client continues to use this solution to date, and even with the anticipated delivery and implementation of vendor enhancements to support the client’s FATCA regulation obligations, the solution will continue to play an integral role in the foreseeable future.